Course 55441 – EP CPE Winter FY14

Plan Terminations

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INTERNAL REVENUE SERVICE
TAX EXEMPT AND GOVERNMENT ENTITIES

Objectives

Objectives

At the end of this chapter, you should be able to:

- Determine and verify the date of termination for defined contribution and defined benefit plans (both covered and non-covered PBGC plans), the timeliness of a determination application, and the permanency requirements for plans.
- List the accelerated vesting requirements. (complete, partial , complete discontinuance)
- Verify trust asset information.
- Determine the funding obligations under IRC § 412.
- List the consequences and procedures for plans that are underfunded or overfunded.
- List the prohibited transaction and unrelated business taxable income rules and determine how such rules protect the interests of plan participants.
- Determine the continuing § 401(a) compliance requirements for plans to remain qualified, including how specialists verify which prior law changes a plan must be amended for.

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Establishing The Termination Date

Introduction

In order to terminate a qualified plan:

- The date of termination must be established,
- The benefits of plan participants and other liabilities under the plan must be determined with respect to the date of termination, and
- All plan assets must be distributed in accordance with plan terms as soon as administratively feasible.

Issues with respect to a termination

If a termination has occurred, we are concerned with when the plan terminated for the following reasons:

- Accelerated vesting per IRC § 411(d)(3).
- Accrual requirements per IRC § 411(b).
- Funding obligations per IRC § 412.
- Reversion of assets to the Employer, which may be subject to excise tax per IRC § 4980.
- Continuing 401(a) compliance per Revenue Ruling 89-87.

Published Authority

Section 1.416-1, T-4 of the regulations defines a terminated plan as one which has been formally terminated, under which crediting service has ceased for vesting and benefit accruals and under which plan assets have been, or are being, distributed as soon as is administratively feasible.

Section 1.416-1, T-5 provides that a plan that has not distributed assets as soon as administratively feasible is subject to the minimum contributions or benefit requirements per IRC section 416.

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Establishing The Termination Date, Continued

As soon as administratively feasible

Whether a distribution is made as soon as administratively feasible is based on the facts and circumstances of the case.

Generally, a distribution which is not completed within one year following the date of proposed date of plan termination will be presumed not to have been made as soon as administratively feasible.

Ongoing plan

A plan that has not distributed assets as soon as administratively feasible is considered an ongoing plan and must continue to meet the qualification requirements of IRC section 401(a) and the minimum funding requirements of IRC section 412 (if applicable).

When is a plan terminated – Defined Benefit Plans – Covered by Title IV of ERISA?

When a defined benefit plan is considered terminated is dependent upon whether the plan is covered by Title IV of ERISA. The PBGC is charged with the responsibility of administering Title IV of ERISA, which guarantees the payment of certain benefits under terminated defined benefit plans.

A defined benefit plan is covered by Title IV if it has obtained a favorable determination letter from the IRS or, for the preceding five plan years, has in practice satisfied the qualification requirements under IRC §401(a). *See* ERISA §4021(a).

Exceptions to coverage of Title IV

There are some exceptions to coverage under Title IV which are listed in ERISA §4021(b). The following plans are not covered by Title IV:

- Professional Service Employers that are a proprietorship, partnership, corporation, or other association or organization with fewer than 26 participants
- Substantial Owners,
- Church Groups,
- Federal, State or Local Governments,
- Indian Tribal Government Plans, and
- Defined Contribution Plans.

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Establishing The Termination Date, Continued

DB plan termination--Title IV

The exclusive means of terminating a defined benefit plan that is subject to Title IV of ERISA is compliance with the procedures under ERISA §4041.

If title IV is not applicable

When Title IV is not applicable, termination of the defined benefit will typically be established by the effective date stated in the ERISA §204(h) notice or, where ERISA §204(h) is not applicable, in a resolution adopted by the employer.

See Treas. Reg. §1.411(d)-2(c)(2).

Date of termination

Under ERISA § 4041, the date of termination for plans subject to Title IV:

- **Standard termination –** the termination date is established by the plan administrator.
- **Distress termination –** the termination date is established by the plan administrator and agreed to by PBGC.
- **Involuntary termination –** the termination date is established by PBGC and agreed to by the plan administrator or court.

When distributions can be made

If the terminated plan is covered by Title IV of ERISA, distributions cannot be made until the employer notifies PBGC and provides the applicable procedures are followed.

Specific forms must be filed with the PBGC on or before the 180th day after the proposed termination date.

PBGC has 60 days after receiving these forms to review the termination for compliance with the law and regulations.

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Establishing The Termination Date, Continued

Date of termination is significant

The date of plan termination is significant because it is the date on which:

- Benefit accruals stop,
- Contribution obligations stop, and
- Liability to the PBGC is measured.

Standard and distress termination

When is a plan terminated – DB -Standard Termination

*A **standard termination*** is defined as a plan having enough assets to pay all benefits owed to participants and/or beneficiaries.

The employer must file Form 500, Standard Termination Notice, along with Schedule EA-S, Standard Termination Certification of Sufficiency, with the PBGC.

In addition, the affected participants must be provided 60-day advance notice. The PBGC has 60 days to review the termination for compliance with the law and regulations.

See ERISA §4041(b) and PBGC Regs. §4041.21 through §4041.3.

When is a plan terminated – DB – Distress Termination

A ***distress termination*** is defined as a plan without enough assets to pay all benefits owed the participants and/or beneficiaries.

The plan sponsor can initiate a distress termination if it can show that it meets one of four distress tests specified by ERISA:

1. Reorganization distress test,
2. Business continuation distress test,
3. Liquidation distress test, or
4. Pension cost test.

Reorganization distress test.

Under the reorganization distress test:

- The company must be in reorganization in bankruptcy or insolvency proceedings, and
- The bankruptcy court must find that unless the plan is terminated, the company cannot pay all its debts under a plan of reorganization and cannot continue in business outside a Chapter 11 reorganization.

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Standard and distress termination, Continued

Business continuation distress test

Under the business continuation distress test, the company must demonstrate to the PBGC that, unless a distress termination occurs, the company cannot:

a. pay its debts when due; and

b. continue in business.

Liquidation distress test

Under this test, the company must have filed, or had filed against it, a petition seeking liquidation under federal or state law which has not been dismissed.

Pension cost test

Under this test, the company must demonstrate to the PBGC's satisfaction that the company's costs of providing pension benefits have become unreasonably burdensome solely as a result of declining covered employment.

Statutory and regulation authority

See ERISA §4041(c) and PBGC Regs. §4041.41 through 4041.50.

If the plan does not qualify for a distress termination

If a plan does not qualify for a distress termination, PBGC will notify the employer that the conditions stated above have not been met and the plan will remain ongoing and monitored by PBGC.

In a distress termination, the employer must file Form 601 with Schedule EA-D on or before the 120th day after the proposed Termination. Additionally, a 60-day advance notice is required to be given to the affected participants.

When PBGC can terminate a plan

When PBGC can terminate a plan

Under ERISA §4042, PBGC can terminate a pension plan, even if the employer has not filed a notice to terminate the plan, if:

- The plan has not met the minimum funding requirements,
- The plan cannot pay current benefits when due,
- A lump sum payment has been made to a participant who is a substantial owner of the sponsoring company, or
- The loss to PBGC is expected to increase unreasonably if the plan is not terminated.

DB involuntary termination- when PBGC must terminate

The PBGC **must** initiate an involuntary termination if it determines that a plan does not have assets available to pay benefits currently due under the plan.

DB involuntary termination-- when PBGC may terminate

The PBGC **may** initiate an involuntary termination, at its discretion, after making one of three other statutory findings:

1. The plan has not met the minimum funding requirements. In the PBGC's view, this occurs only when a funding deficiency arises. Generally, missing a quarterly payment would not permit the PBGC to make this finding.

2. The PBGC's possible long run loss for the plan may increase unreasonably if the plan is not terminated. The PBGC applies the "long run loss" standard by comparing its liability risk for the plan assuming a termination before a specific transaction to its liability risk for the plan assuming a termination after the transaction. If the transaction, for example, would substantially increase plan liabilities or reduce the PBGC's ability to collect termination liability, the PBGC could conclude that it faces a long run loss if the plan is not terminated.

3. There has been a distribution to a substantial owner that caused the plan to become underfunded.

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When PBGC can terminate a plan, Continued

Once PBGC makes its findings

After making one of the findings, the PBGC can enter into an agreement with the plan administrator to terminate the plan on a proposed termination date.

If the plan administrator does not agree to the termination, the PBGC can ask a court to order termination of the plan based on a finding that termination is necessary to:

- Protect the interest of plan participants.
- Avoid any unreasonable deterioration of the financial condition of the plan.
- Avoid any unreasonable increase in the PBGCs liability.

Defined contribution termination

When is a plan terminated – Defined Contribution plans

For defined contribution plans, the termination date is based on all facts and circumstances.

Typically, a resolution adopted by the employer (e.g., board resolution adopted by the Board of Directors of a corporate plan sponsor) is sufficient to establish the termination date.

See Treas. Reg. §1.411(d)-2(c)(3) and §1.401-6(b).

Factors indicating a DC termination

The following factors have been found to be determinative as to whether an employer has terminated its profit sharing plan:

- Whether the Form 5500s indicate a plan termination,
- Whether plan participants are notified of the plan's termination, and
- Whether the value of the distributed benefits is equal to the value of the vested account balances.

See Gant v. Commissioner, 76 T.C.M. 994 (1998).

Required notices

Notice of a significant reduction in accruals

In a pension plan, administrators must notify plan participants and alternate payees of any amendment which provides for a significant reduction in the rate of future benefit accruals.

The notice must be provided not less than 15 days before the effective date of such amendment. *See* ERISA §204(h).

Notice to interested parties

Plan sponsors or administrators must provide notice to interested parties. *See* Treas. Reg. §1.7476-2. Interested parties are defined under Treas. Reg. §1.7476-1.

The notice must be provided not less than 10 days or more than 24 days prior to the date an application is submitted to the Service for a Determination Letter Upon Plan Termination. *See* Rev. Proc. 2013-6.

Who receives the notice to interested parties

The following individuals must be provided the notice to interested parties:

- Employees eligible to participate under the plan,
- Employees with accrued benefits under the plan, or former employees with vested benefits under the plan,
- Beneficiaries of deceased former employees who are eligible to receive or are currently receiving benefits under the plan, and
- Employees not eligible to participate under the plan.

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Required notices, Continued

How the notice to interested parties is delivered

The notice must be delivered to interested parties in accordance with the methods described in §1.7476-2(c). The notice is deemed to be provided in a manner that satisfies §1.7476–2(c) if the notice is delivered using an electronic medium under a system that satisfies the requirements of §1.402(f)–1 Q&A–5. *See* Treas. Reg. §601-201(o)(3).

If the notice is delivered in person or by posting it must be dated not less than 7 days after or more than 21 days prior to the date of the application for a determination letter.

If the Notice is delivered by mail it must be postmarked not less than 10 days after or more than 24 days prior to the date the application for determination is made.

Permanency and other issues

Permanency

If a plan is terminated within a few years after its adoption without a valid business reason, there is a presumption that it was not intended to be a permanent program from its inception. Generally, a few years is defined as less than 10 years. *See* Treas. Regs. §1.401-1(b)(2).

Facts and circumstances will determine if the permanency criteria is met.

Valid business reasons for termination

Valid business reasons for plan termination include:

- Bankruptcy or insolvency of the employer,
- Discontinuance of the employer’s business,
- Substantial change in stock ownership of the employer,
- Merger, and
- Substitution of another type plan.

Tips for determination agents

The following steps should be followed to determine permanency:

- Review line 10 of Form 5310 which indicates the reason for termination,
- If the plan terminated within a few years after its adoption, determine if it was for a business necessity,
- If “adverse business conditions” is checked, additional information should be provided with the application, and
- If “other” is checked, additional information should be provided.

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Early termination rules

Defined benefit plans must incorporate certain provisions restricting benefits and distributions to prevent discrimination that may occur in the event of early termination of a plan.

A defined benefit plan must provide that, in the event of plan termination, the benefit of any HCE (and any HCE that is a former employee) is limited to a benefit that is nondiscriminatory pursuant to IRC section 401(a)(4).

See Treas. Reg. §1.401(a)(4)-5(b)(2).

Orphaned plans

Regulations permit "qualified termination administrator" to terminate and liquidate abandoned or orphan plans. Regulations issued by the DOL facilitate the termination of, and distribution of benefits from, defined contribution plans that have been abandoned by their sponsoring employers ("orphan plans").

See DOL Reg. §2578.1, Appendixes A through D to §2578.1, §2520.103-13, 71 F.R. 20820,20828-20830, 20850-20853 (April 21, 2006).

Distributing the assets

Overview of Form 6088

Form 6088, Distributable Benefits from Employee Pension Benefit Plans, must be submitted with Form 5310 applications for all defined benefit or underfunded defined contribution plans.

Plan sponsor of a collectively bargained underfunded DC plan

A plan sponsor of a collectively-bargained underfunded defined contribution plan must file a Form 6088 only if the plan benefits employees who are not collectively bargained or more than 2% of the employees covered by the plan are professional employees. *See* Treas. Reg. §1.410(b).

Professional employees are defined under Treas. Reg. §1.410(b)-9.
Each employer participating in a multiple employer defined benefit or underfunded defined contribution plan need to file a separate Form 6088.

When 6088 is completed

The plan sponsor will complete Form 6088 based upon the participant data as of the date of plan termination or proposed date of termination.

Information Included on the Form 6088-standard termination

For a standard termination of a defined benefit plan, all columns on Form 6088 must be completed, except for (g)(1), (g)(2), and (g)(3). If there are fewer than 25 participants, the plan sponsor must list all of the participants.

Underfunded DB plans

Underfunded defined benefit plans, except those benefiting only collectively bargained employees of which not more than 2% are professional employees, must complete all columns on Form 6088. If there are more than 25 participants, the plan sponsor must attach additional sheets providing the information in the same format as Form 6088.

Underfunded DC plan

For an underfunded defined contribution plan, columns (a), (b), (e), (g)(1), (g)(3), and (h) must be completed.

Details on Form 6088

Column (a)

Column (a) on Form 6088 identifies the participants. A participant is defined as any individual who satisfied the plan participation requirements and is entitled to receive plan benefits. This includes employees with accrued nonvested benefits and individuals who are former employees at the time of plan termination and are entitled to future benefits under the plan.

How to list the participants

The list of participants should be in the following order:

- First, any participant who at any time during the 5-year period prior to the date of termination or proposed plan termination owned directly or indirectly 5% or more of the voting stock or 5% or more of the business.
- Next, all remaining participants in order of compensation starting with the highest paid to the next highest paid, etc.

Column (b)

Column (b) on Form 6088 indicates if the participant in column (a) is a Highly Compensated Employee (HCE).

Column (c)

Column (c) on Form 6088 represents the years of participation a participant has in the defined benefit plan prior to the earliest of:

(a) plan termination,

(b) retirement, or

(c) separation from employment.

If the accrued benefit described in column (f) is based on years of credited service that is different than the years of participation reported in column (c), the plan sponsor should attach a separate schedule adding this information for each participant.

Column (d)

Column (d) indicates the participant’s age as of plan termination in the defined benefit plan.

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Details on Form 6088, Continued

Column (e)

Column (e) on Form 6088 indicates the participant's compensation as defined under Treas. Reg. §1.415(c)-2.

For defined benefit plans, compensation is average compensation for the high 3 years. This is defined as compensation determined on an annual basis for the period of consecutive calendar years (but not more than 3) during which the participant was both an active plan participant and had the greatest aggregate compensation from the employer.

For any participant no longer employed as of the proposed termination date, compensation and years of participation from the earliest of: (a) the proposed date of plan termination, (b) retirement, or (c) separation from employment is used.

Column (e) if accrued benefit based on other compensation

If the accrued benefit described in column (f) is based on compensation other than the "high 3 years," the plan sponsor must attach a separate schedule reporting the average compensation used to determine the accrued benefit for each participant.

Column (e)-DC plans

For defined contribution plans, compensation is defined as the participant's compensation for the current 12-month period. The current 12-month period can be the last calendar or plan year ending on or before the plan termination.

For participants no longer employed as of the proposed termination date, compensation is the amount received for the applicable period immediately before the earlier of retirement or separation from employment.

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Column (f)

For a defined benefit plan, Column (f) is the participant's accrued benefit as of the date of plan termination in the normal form payable at normal retirement age (NRA) under the plan, excluding any benefits attributable to voluntary employee contributions (including rollovers).

If the accrued benefit for any participant is adjusted from the plan's regular benefit formula (for example, due to top-heavy minimum benefits, IRC 415 limits, or offsets) the plan sponsor should attach a detailed calculation of these differences.

*Note: The accrued benefit may be expressed in a monthly or annual amount.

Column (g)

If the sum of the amounts on line 28 of Form 6088 does not equal the sum on line 20(l) of Form 5310, the plan sponsor is required to provide an explanation.

For an underfunded defined benefit plan, the amount in column (g)(1) is the amount allocated in accordance with §4044(a)(1) and (2) of ERISA.

Column (g)(2) is the amount allocated in accordance with § 4044(a)(3) and (4)(A).

Column (g)(3) is the amount allocated other than those entered in columns (g)(1) and (2).

Column (f) for DC plans

For defined contribution plans, the amount in column (g)(1) is the total assets distributable to each participant attributable to mandatory and voluntary employee contributions and rollover contributions.

Column (g)(2) should be blank.

Column (g)(3) is the total assets distributable to each participant attributable to employer contributions including elective deferrals to a qualified cash or deferred arrangement (CODA) and employer matching contributions.

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Details on Form 6088, Continued

Column (h)

For defined benefit plans, Column (h) is the present value of the participant's total benefit (whether or not nonforfeitable) at the date of termination of the plan.

For purposes of Form 6088, the present value is the single sum distribution amount provided under the terms of the plan. If the plan does not provide for single sum distributions, the present value is the cost of the annuity.

The plan sponsor must provide a statement explaining the derivation of the present values. This statement should include the interest rates and mortality table used to compute the single sum distributions.

Defined Terms

Normal retirement benefit	Normal Retirement Benefit - the benefit promised to the participant in the normal form of benefit at the normal retirement age (NRA).
Normal form of benefit	Normal Form of Benefit (NFOB) - The "default" form of payment of the Normal Retirement Benefit, which must be defined by the plan. This is often a straight life annuity (SLA).
Normal retirement age	Normal Retirement Age (NRA) - the age at which the participant can retire and receive a pension benefit under the terms of the plan and in accordance with IRC § 411(a)(8).
Actuarial equivalence	Actuarial Equivalence - A method of equating differing methods of payment at different point of time, such that the different payments are of equivalent value.
Actuarial assumptions	Actuarial assumptions--the stated factors involving interest, mortality, etc., that are used to establish actuarial equivalence. These factors must be stated in the plan document in a manner that precludes employer discretion (IRC § 401(a)(25)).
Mortality table	Mortality Table - A set of actuarial functions and computational results that are used to estimate future mortality.
Interest rate	Interest Rate - the rate at which assets are assumed to grow.
Annuity purchase rate	Annuity Purchase Rate (APR) - the rate when combining the mortality table and interest rate at a specific age.
Accrued benefit	Accrued Benefit – the portion of the normal retirement benefit that the participant has accrued at a specific date, prior to normal retirement age.

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Defined Terms, Continued

Credited service	Credited Service (or similar term) – the period of time at which the accrual computation period is measured for benefits. Common terms used include year of participation, years of service, benefited service, accrual service, etc.

Steps to review Form 6088

Six Steps to Review 6088

There are six steps to determine if the plan sponsor’s methodology for calculating benefits is correct:

1. Apply the benefit formula to obtain the accrued benefit for the participant,

2. Convert the normal form of benefit to the actuarial equivalent optional form of benefit (lump sum “LS”) using the plan rates,

3. Determine the minimum lump sum distribution using the applicable interest rate (AIR) and applicable mortality table (AMT) - IRC 417(e)(3) rates,

4. Compare the Minimum Lump Sum Distribution using the Plan Rates and IRC § 417(e)(3) Rates,

5. Determine the Maximum Lump Sum Distribution under IRC § 415, and

6. Compare and Conclusion.

First step--apply the benefit formula to obtain the accrued benefit

Obtain the benefit formula

Obtain the benefit formula from the plan document.

Caution: If the benefit formula is based upon average annual compensation, the plan document may state a different definition then what is required on Form 6088. Therefore, additional information from the sponsor may be needed.

Obtain the accrued benefit

Then determine the annual benefit of the participant. Keep in mind that the accrual formula must comply with one of the rules specified in IRC § 411(b).

Example--facts

The following example will be used throughout this section to illustrate the calculation of benefits.
The information for our participant, Tom, is as follows:

- AAC (average annual compensation) = $160,000
- CS (credited service) = 8 years
- YOP (years of participation) = 8 years
- Accrual rule = 133-1/3 rule
- NFOB (normal form of benefit) = SLA
- Optional form of benefit = Lump Sum
- Current age = 60
- NRA (normal retirement age) in plan = 65
- Distributions are expected to be made in 2012
- DOT: 1/15/12
- PYE: 12/31

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First step--apply the benefit formula to obtain the accrued benefit, Continued

Plan formula and accrued benefit

The defined benefit plans benefit formula is 5% of Average Annual Compensation x Credited Service (up to 15 years).

The accrued benefit is:

5% x $160,000 x 8 = $64,000.

$64,000 represents the annual accrued benefit payable at NRA of the plan.

Remember, Form 6088 may either show the accrued benefit in an annual or monthly amount. In this particular example, it is expressed in a monthly amount on Form 6088, therefore, $64,000 will need to be divided by 12.

$64,000 / 12 months = $5,333

$5,333 represents the monthly accrued benefit payable at NRA of the plan.

Compare benefit with column (f)

Compare the figure obtained above to the figure in column (f) on Form 6088.

As stated in the directions to Form 6088, column (f) represents a participant's accrued benefit as of the date of plan termination in the normal form payable at normal retirement age (NRA) under the plan.

Optional Forms of Benefit

If a participant elects to receive their benefit in a form other than the normal form of benefit (generally, a single life annuity), then the normal form of benefit will be converted to the actuarial equivalence of such optional form (lump sum).

Participants in pay status who are receiving benefits in an optional form will be noted on Form 6088, column (f), with an asterisk. An attachment to Form 6088 explaining the asterisk and describing the optional benefit form is required.

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First step--apply the benefit formula to obtain the accrued benefit, Continued

Exception for subsidized benefits

Exception: A plan may "subsidize" the Qualified Joint & Survivor (J & S) option by providing a J & S annuity in a dollar amount equal to the life annuity form.

This is a subsidy because the J &S form of benefit is **more valuable** than a life annuity, and if provided on a true actuarial equivalence basis, the dollar amount of the J &S annuity would typically be less than the life annuity.

Annuity purchase rate (APR)

Before the normal form of benefit can be converted into the actuarial equivalent of the optional form of benefit, the annuity purchase rate (APR) must be determined. Where the normal form is a single life annuity, the APR represents the present value of a life time annuity of $1 per year, paid monthly at a specific age. This rate is achieved by combining the mortality table and interest rate at that specific age.

Sometimes the APR will be expressed as the present value of $12 per year, paid monthly (i.e. $1 per month).

- When the APR is a higher number, usually in the value range of 96 to 144, the APR is expressed as the present value of $1 per month.

- When the APR is a smaller number, usually in the value range of 8 to 12, the APR is expressed as the present value of $1 per year.

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First step--apply the benefit formula to obtain the accrued benefit, Continued

Obtaining the APR

The easiest way to obtain an APR is to use a portion of the cross-testing spreadsheet located on the Shared Server at:

H: Drive / "Mortality Table" folder / "401(a)(4) Cross test with Gar 94 CC 2007".

The yellow cells are the only input fields. Enter the following information:

- On Row 3, Column D – enter the mortality table numeric code which is located under Columns I for the mortality table that is being used, once you enter this numeric code, then the mortality table will be shown under Row 4, Column D.
- On Row 5, Column D – enter the pre-retirement interest rate
- On Row 6, Column D – enter the post-retirement interest rate
- On Row 7, Column D – enter the retirement age stated in the plan
- On Row 12, Column D – enter the current age of the participant.

Results

After the above information is entered, the APR will be provided:

Row 10, Column D shows the annuity purchase rate (APR) for the participant at normal retirement age.

Second step-convert the normal form of benefit to the actuarial equivalent optional form of benefit (lump sum "LS") using the plan rates

Applying the second step to the example

Continuing the example, the participant, Tom, has elected to take a lump sum distribution instead of a single life annuity (normal form of benefit).

The actuarial assumptions used to convert the normal form of benefit to an optional form must be defined in the plan document. Locate the definition of actuarial equivalence (or similar term) in the plan document in order to determine what rates the plan is using.

In this example, the plan document states the pre-retirement and post-retirement interest rate is 5%. The plan states that there will be no pre-retirement mortality (because full vesting is provided upon death prior to retirement). For post-retirement, the mortality table will be the 1983 GAM-U table.

Multiply the accrued benefit by the APR

In Step Two, **<u>first</u>**, take the annual accrued benefit from step one and multiply it by the APR to achieve the lump sum amount at NRA. If using the monthly accrued benefit, remember to multiply the number by 12 to achieve the annual accrued benefit.

Applying example--calculating lump sum

The annual accrued benefit from step one = $64,000
The APR using the plan rates = 11.534

$64,000 x 11.534 = $738,176 which represents the lump sum payment at NRA of the plan.

Discounting back to current age

However, Tom has not reached his NRA. Consequently, this amount must be discounted from NRA (as defined in the plan) to his current age.

<u>Next</u>, discount the lump sum payment to the current age of the participant.
$738,176 x $(1.05)^{-5}$ = $578,380 which represents the single sum payment at current age

The 1.05 represents the interest rate and $^{-5}$ is the number of years being reduced from age 65 to 60.

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Second step-convert the normal form of benefit to the actuarial equivalent optional form of benefit (lump sum “LS”) using the plan rates, Continued

Optional forms of benefit

Any optional forms of benefit specified in the plan are either subject to or not subject to IRC § 417(e)(3).

IRC § 417(e)(3) proscribes an applicable mortality table that requires the Treasury to base the mortality table on the actual experience of pension plans and projected trends in such experience, taking into account the results of available independent studies of mortality of individuals covered by pension plans. The applicable mortality table is used to determine the participant’s maximum benefits.

> Under Treas. Regs. §1.417(e)-1(d)(6), forms of benefit based on the life of the participant or a non-decreasing life annuity **are not subject** to IRC § 417(e)(3).
>
> Forms of benefit such as a lump sum payment or installments **are subject** to IRC § 417(e)(3).

Forms of Benefit Subject to IRC §417(e)(3)

If the payment is made in a form subject to IRC § 417(e)(3), there are minimum standards for such benefit that will be converted to an actuarial equivalent straight life annuity (SLA) using the assumptions, which produce the **greater annual benefit** using:

1. The Plan Rates, or
2. The Applicable Interest Rate and the Applicable Mortality Table.

Applicable Interest Rate and Applicable Mortality Table

For Plan years beginning on or after January 1, 2008, the Applicable Interest Rate (AIR) is the first, second and third “segment rates”, which are based on corporate bond yield curves. Each segment rate applies to cash flows during specified periods.

First segment rate

The first segment rate is applied to benefit cash flows that are payable during the five year period beginning on the first day of the plan year (years 1- 5).

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Second step-convert the normal form of benefit to the actuarial equivalent optional form of benefit (lump sum “LS”) using the plan rates, Continued

Second segment rate

The second segment rate is applied to benefit cash flows payable during the beginning at the end of the five year period described above (years 6 – 20).

Third segment rate

The third segment rate is applied to benefit cash flows payable after the end of the fifteen year period described above (years 21+).

Applicable mortality table

The Applicable Mortality Table (AMT) is specified under IRC 430(h)(3)(A); each year the IRS publishes a new applicable mortality table.

Annuity starting dates that occur within a stability period will use the AMT for the calendar year in which the stability period begins. For example, for a plan year September 1 – August 31, and a plan year stability period, the 2008 Applicable Mortality Period would apply for all distributions with annuity starting dates on or after September 1, 2008 through August 31, 2009.

Lookback Month and Stability Period

The Lookback Month is the month a plan looks to in determining the interest rate (which remains constant during the stability period). This month can be the first, second, third, fourth, or fifth calendar month (or a combination of an average) immediately preceding the stability period.

The Stability Period is the period in which the interest rate for the lookback month is used to calculate each distribution commencing within such period.

Continued on next page

Second step-convert the normal form of benefit to the actuarial equivalent optional form of benefit (lump sum "LS") using the plan rates, Continued

Finding the Applicable Interest Rate and Applicable Mortality Table

To calculate the segment rates, the definitions for the lookback month and stability period need to be obtained from the plan document.

In our example involving Tom, the participant, the plan defines the lookback month as the second calendar month preceding the stability period.

The stability period is defined as the plan year. Distributions are expected to be made in 2012. The plan year end is 12/31.

The second calendar month preceding the plan year is November 2011 since distributions will be made in 2012.

The segment rates can be found on the IRS website:
http://www.irs.gov/Retirement-Plans/Minimum-Present-Value-Segment-Rates

Third step-determining the minimum lump sum distribution using the applicable interest rate and applicable mortality table under IRC section 417(e)(3)

Applying the example

Since the participant, Tom, elected an optional form of benefit (lump sum) that is subject to IRC § 417(e)(3), the minimum lump sum distribution must be determined using the AIR and the AMT.

The November 2011 segment rates, which are found on the IRS website, are as follows:

1st segment: 1.99%

2nd segment: 4.47%

3rd segment: 5.26%.

Using an examination tool to verify lump sum distributions

An examination tool on the shared server can be used to apply the segment rates to verify lump-sum distributions.

Under the “417(e) Lump Sum” tab on the spreadsheet tool, fill in the yellow boxes with the appropriate data for Tom’s benefit distribution.

As previously stated, this plan does not provide for pre-retirement mortality because full vesting is provided upon death.

When completed, the examination tool “417(e) Lump Sum” tab will appear as follows:

Continued on next page

Third step-determining the minimum lump sum distribution using the applicable interest rate and applicable mortality table under IRC section 417(e)(3), Continued

Examination tool

Calendar Year Mortality Table (2008, 2009, etc)		**2012**
	Preretirement Mortality (yes or no)	**no**
	1st segment rate	**1.99%**
	2nd segment rate	**4.47%**
	3rd segment rate	**5.26%**
Ages may include decimals	**Retirement Age:**	**65.000**
	Current Age:	**60.000**
	Benefit	**$64,000**
	Benefit payable monthly (M) or annually (A)	**A**
Annual Lump Sum Factor		**9.79194**
Lump Sum		**$626,684.16**

Fourth step-compare the lump sums

Applying the example

Under Step Two, it was determined that by using the rates in the plan, the participant, Tom, was entitled to receive a lump sum payment of $578,380.

Under Step Three, it was determined that using the §417(e)(3) rates, Tom must receive a minimum lump sum payment of no less than $626,684.

For Step Four, determine which rates provide the greater benefit:

Lump sum using plan rates = $ 578,380

Lump sum using IRC § 417(e)(3) Rates = $626,684, which is the greater **benefit**

Compare the benefit calculated above to the Form 6088. If there is a discrepancy, additional information from the plan sponsor may be required.

Fifth step--determining the maximum lump sum distribution under section 415

Introduction

If a participant's benefit is paid in a form other than the annual benefit (single life annuity), the benefit must be adjusted to an actuarially equivalent annual benefit to determine if the section 415 limit is exceeded.

See IRC §415(b)(2)(B). For example, if the participant elects a lump sum payment, the actuarial equivalent of that payment expressed as a single life annuity must not exceed the section 415 limit.

Limits under section 415

Under IRC § 415(b), a participant’s benefit is limited to the lesser of:

1) 100% of Average Annual Compensation (referred to as the *Compensation Limit*), or

2) $160,000 (refer to as the *Dollar Limitation*) as adjusted by COLAs.

DB Dollar Limit with COLAs

The defined benefit dollar limitation adjusted by COLAs for the years 2004 through 2013 is:

Year	DB Dollar Limit
2004	$165,000
2005	$170,000
2006	$175,000
2007	$180,000
2008	$185,000
2009	$195,000
2010	$195,000
2011	$195,000
2012	$200,000
2013	$205,000

Continued on next page

Fifth step--determining the maximum lump sum distribution under section 415, Continued

Compensation Limitation Adjustment

The compensation limit under 1) above is available only if the participant has at least 10 years of service with the employer.

If the participant has less than 10 years of service, the compensation limit equals 10% of average annual compensation multiplied by the number of years of service.

Example

If a participant has only 6 years of service with the employer, the compensation limit would be adjusted to 60% (10% x 6 years of service) of average annual compensation.

Dollar Limitation Adjustment

The dollar limitation under 2) above is available only if the participant has at least 10 years of participation when benefits commence.

If the participant has less than 10 years of participation, the dollar limit is multiplied by a fraction, the numerator of which is the number of years of participation and the denominator is 10.

Example

If a participant has 5 years of participation, the dollar limit is 50% (5/10 years) of the dollar limit ($175,000 x 50% = $87,500)

Continued on next page

Fifth step--determining the maximum lump sum distribution under section 415, Continued

Rates for Testing 415 Limits-subject to 417(e)(3)

When determining the 415 limit, if the form of benefit is subject to IRC § 417(e)(3), the interest rate used to determine the maximum benefit is equal to the greater of:

Effective 1/1/06:

1) The Plan Rates,

2) 5.5% (under PFEA) and Applicable Mortality Table, or

3) The rate that would provide a benefit of not more than 105% of the benefit that would be provided if the § 417(e)(3) rate were used and applicable mortality table.

Rates when benefit is not subject to 417(e)(3)

If the form of benefit is not subject to IRC § 417(e)(3), the interest rate to determine the maximum benefit is equal to the greater of:

- The Plan Rates, or
- 5% and Applicable Mortality Table.

Continued on next page

Fifth step--determining the maximum lump sum distribution under section 415, Continued

Limitation Adjustment

Adjustments must be made to the DB dollar limitation for early and late commencement of benefits. EGTRRA changed the ages at which the DB dollar limitation must be adjusted for early and late commencement of benefits.

Effective for limitation years ending after December 31, 2001:

- the dollar limitation is adjusted for commencement of benefits prior to age 62,
- no adjustment is required for benefits that commence from age 62 to age 65; and
- the dollar limitation will be adjusted for late commencement where benefits commence after age 65.

Limitation Adjustment – Prior to Age 62

If benefits commence prior to age 62, the dollar limit at the earlier age is the lesser of:

1. the equivalent amount computing the interest rate and mortality table used for actuarial equivalence for early retirement benefits under the plan, and
2. the equivalent amount computed using 5% interest and the applicable mortality table.

Limitation Adjustment – After Age 65

If benefits commence after age 65, the dollar limit is actuarially increased to the later age based on the lesser of:

1) the equivalent amount computing the interest rate and mortality table used for actuarial equivalence for late retirement benefits under the plan, and

2) the equivalent amount computed using 5% interest and the applicable mortality table.

Continued on next page

Fifth step--determining the maximum lump sum distribution under section 415, Continued

Putting it all together

In Step Five, determine if the distribution amount does not exceed the IIRC § 415 limit as follows:

415(b) limits

Under § 415(b), a participant's benefit is limited to the lesser of:

(1) Dollar Limit or

(2) the Compensation Limit.

Additionally, these limits are **further** reduced for less than 10 years of participation and 10 years of service, respectively.

Applying the example-Tom

Determine the 415(b) dollar limitation for Tom. As distributions will be made in 2012, the DB dollar limit is $200,000. Tom has 8 years of participation at the time of distribution. Therefore, his adjusted DB dollar limit is:

> $200,000 x 8/10 = $160,000. This is the reduced DB dollar limit for any age between 65 and 62. Since Tom is 60, his dollar limit at age 60 must be calculated.

Continued on next page

Fifth step--determining the maximum lump sum distribution under section 415, Continued

Reduce the dollar limit from 62 to 60

This is done by first multiplying the $160,000, the reduced DB dollar limit, by the APR at 62, which is 12.981, which represents the lump sum at age 62.

The APR is determined using the plan interest rate or 5%, whichever produces the lesser limit.

> $160,000 x 12.981, which is $2,076,960.

The next step is the multiply the lump sum at age 62 by a discounting factor for 2 years using 5% interest.

> $2,076,960 x 1.05^{-2} or $1,883,864.

Finally, divide the lump sum amount by the APR at age 60, which is 13.557.

> 1,883,864/13.557 is $138,959. This is the defined benefit limit for Tom.

Interest rate and other factors

The “1.05” represents the interest rate (both the plan interest rate and the 5%) and $^{-2}$ represents the number of years being reduced from age 62 to 60. The APRs use the 2012 applicable mortality.

<u>Reminder</u>: no adjustment is required for benefits that commence from age 62 to age 65.

<u>Note</u>: this plan does not provide a pre-retirement mortality decrement, and therefore the ratio of APRs at 62 and at age 60 can be used to determine the reduced dollar limit.

For cases involving pre-retirement mortality decrements, contact your Area Actuary.

Continued on next page

Fifth step--determining the maximum lump sum distribution under section 415, Continued

Determine the 415 compensation for Tom

Determine the 415 compensation limit for Tom. His average annual compensation is $160,000 and he has 8 years of service. Therefore, his adjusted compensation limit is:

$160,000 x 8/10 = $128,000 which represents the reduced compensation limit.

Take the lesser of the dollar or compensation

Take the lesser of the dollar or compensation limit obtained above.

Compensation limitation = **$128,000, which is the lesser limit.**

Determine the greater benefit

Since the distribution will be made in a lump sum and subject to §417(e)(3), determining the **greatest equivalent annuity benefit (based on the lump sum),** using, **(**effective 1/1/06**)**:

a) The Plan Rates,

b) 5.5% (under PFEA) and Applicable Mortality Table, or

c) The rate that would provide a benefit of not more than 105% of the benefit that would be provided if the § 417(e)(3) rate were used and applicable mortality table.

Continued on next page

Fifth step--determining the maximum lump sum distribution under section 415, Continued

Determine the equivalent annuity

Determine the equivalent annuity deferred to age 65, based on the lump-sum paid at age 60:

Using the plan rate rates of 5% and 1983 GAM-U mortality under the plan:

$626,684 (Lump sum) / 8.669 (Deferred APR @ 60) = $72,290.

Take the lump sum and divide it by the APR using 5.5% interest and the applicable mortality table.

$626,684 (Lump sum) / 12.923 (APR) = $73,015

Then, take the lump sum and divide it by the APR using the IRC 417(e) required mortality table and segment rates, and divide the result by 1.05. The segment rates in this example are 1.99%, 4.47%, and 5.26%.

The benefit that results from those rates (see above) divided by 1.05:

$64,000 / 1.05 = 60,952.

Determine the largest amount and compare to 415 limit

Finally, determine the largest of the equivalent benefits, and compare to the IRC 415 limit:

$73,015 using 5.5% and applicable mortality.

Final Step in reviewing Form 6088, compare and conclude

Compare and Conclude

In Step Six, **<u>first</u>**, compare the 417(e)(3) equivalent benefit ($73,015) to the age adjusted IRC 415(b) limit at age 60 ($128,000, based on the compensation limit).

<u>Finally</u>, provide a conclusion to your calculations.
The participant's accrued benefit and lump sum distribution on Form 6088 does not exceed the maximum dollar limitation under § 415.

If the minimum § 417(e)(3) distribution is larger than the maximum § 415 limitation, the participant can only receive the maximum § 415 limitation.

Reconciling Form 6088 with the Form 5310

Reconcile the Form 6088 with Form 5310

The plan assets on line 20 of Form 5310 should equal the present value of accrued benefits on line 28 of Form 6088.
If the amounts are equal, then there are enough assets in the trust to pay benefits.

If the asset amount on line 20 of Form 5310 is less than the amount shown on line 28 of Form 6088, the plan is underfunded. In an underfunded defined benefit plan, assets are not sufficient to cover the present value of the accrued benefits for all participants.

If the assets amount on line 20 of Form 5310 is more than the amount shown on line 28 of Form 6088, then the plan is overfunded. In an overfunded defined benefit plan, plan assets exceed the present value of the accrued benefits for all participants.

An underfunded plan does not mean the plan has a minimum funding deficiency under IRC § 412. If a plan is underfunded and the employer agrees to make a contribution to the plan to satisfy all liabilities, the plan will no longer be deemed underfunded.

Processing Steps

The following steps should be taken to reconcile the plan assets on Form 5310 with the total amount of distributable benefits on Form 6088 participants:

Issue	Action
Verify the plan assets on line 20 of Form 5310 and line 28 of Form 6088 are equal as of the same date	No additional action Needed
If the plan assets on line 20 of Form 5310 are less than line 28 of Form 6088 as of the same date	Follow the underfunded procedures
If the plan assets on line 20 of Form 5310 are more than line 28 of Form 6088 as of the same date	Follow the overfunded procedures

Overfunded plans

Overfunded Plans

When plan assets are more than the plan liabilities, the plan is overfunded. This overfunding, or surplus of assets, can be reduced by:

- Reallocating excess assets to plan participants in a nondiscriminatory manner up to the IRC § 415 limits, or
- Reverting excess assets back to the employer, either wholly or partially.

An employer reversion is equal to the amount of cash and the fair market value of other property received, directly or indirectly, by an employer from a qualified plan.

Note: If the plan provides that excess assets will be used to reduce the employer contribution, the plan should be amended to indicate how the excess will be allocated upon plan termination.

Overfunded plans – reversions – contribution returned under limited circumstances

Generally, contributions cannot be returned to the employer once they have been made. However, under IRC § 401(a)(2), Rev. Rul. 91-4, and ERISA § 403(c)(2), contributions may be returned under the following limited circumstances:

- Mistake of fact,
- Disallowance of deduction,
- If the plan fails to initially qualify under IRC § 401(a), and
- Reversion of assets upon plan termination.

Continued on next page

Overfunded plans – reversion of surplus assets

Before a reversion can be made to the employer, the plan **must** provide for such reversion.

Under ERISA § 4044(d), if the reversion is from a defined benefit plan:

- The plan must have provided for such action for 5 calendar years preceding the plan termination date, and
- The reversion must have been due to an **"erroneous actuarial computation"** within the meaning under Treas. Regs. §1.401-2.

A defined contribution plan may only have a reversion of the amount in a suspense account that cannot be allocated due to § 415 limits.

Any amount which is reverted back to the employer will be taxed under the applicable federal tax rates, if such amount was originally taken as a deduction.

Overfunded plans - IRC § 4980 excise tax on the reversion

In addition to any income taxes due, IRC § 4980, imposes a 20% excise on any amount reverted back to the employer from a qualified plan.

The excise tax is increased from 20% to 50% of the amount of the reversion unless

(1) the employer establishes or maintains a qualified replacement plan or

(2) the plan provides benefit increases meeting the requirements of § 4980(d)(3).

The employer is required to file Form 5330 and pay the excise tax by the last day of the month following the month in which the reversion occurs.

Continued on next page

Overfunded plans - Excise tax-20%

The excise tax remains 20% if:

(1) An amendment is adopted to provide at least 20% of the aggregate present value of the surplus is allocated in a pro rata formula to increase to the accrued benefits of all qualified participants up to the IRC §415 limit and the amendment must take effect immediately upon plan termination, or

(2) A direct transfer of 25% of the excess assets to a qualified replacement plan before any amount has been reverted back to the employer where:

   a) at least 95% of the active participants in the terminated plan must be active participants in the replacement plan, and

   b) the amount transferred must be credited to a suspense account and allocated from such account to the accounts of participants no less than rapidly than ratably over a period not to exceed 7 years, which begins with the year of the transfer; however, if the § 415 limit would prevent the amount to be allocated over the 7 year period, it is extended under IRC § 4980(d)(2)(C)(ii).

(3) The employer is in Chapter 7 bankruptcy liquidation (or similar proceeding under state law) on the date of plan termination.

See § 4980(d)(1)-(6)

Overfunded plans – benefits increased

The percentage remains 20% if the benefits of the participants are increased, provided; a plan amendment is adopted during the 60-day period ending on the date of termination of the qualified plan and takes effect immediately on the termination date.

Note: Under 2) above, if more than 25% of the reversion is transferred to the qualified replacement plan, the amount will not be considered taxable income under the applicable federal tax rates; however, the 20% excise tax is still applicable.

See § 4980(d)(2)(B).

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Overfunded plans, Continued

Overfunded plans – Qualified participant

A qualified participant is defined as:

- An active participant,
- A participant or beneficiary in pay status as of the termination date,
- A participant who has a vested accrued benefit as of the termination date and whose creditable service under the terminated plan ends during the period which begins three years before the termination date and ends on the date on which the final distribution of assets occurs, or
- A beneficiary of a participant in the previous bullet, if the beneficiary has a vested right to an accrued benefit as of the termination date.

See § 4980(d)(5)(A).

Overfunded plans – qualified replacement plan

A qualified replacement plan is defined as any type of qualified plan such as a profit sharing plan, money purchase plan, or a defined benefit plan. *See* IRC § 4980(d)(2).

Two or more plans may be aggregated together or a successor employer plan may be taken into account to fulfill the qualified replacement plan requirements. *See* IRC § 4980(d)(5)(D).

Underfunded plans

Underfunded plans

For an underfunded plan to terminate via a standard termination, there are two options:

- Provide supplemental employer contributions to make plan whole, or
- Forego benefits for the majority owner.

Underfunded plans – Supplemental Employer Contribution

If a plan is underfunded, the employer may make a sufficient contribution to the plan, prior to distributions, to ensure the assets equal the amount of liabilities, and subsequently proceed under the standard termination procedures. *See* PBGC Reg. § 4041.21(b)(1).

Underfunded plans - Forego Benefits by Majority Owner

An underfunded plan may also provide that:

- The majority owner, who is a participant with an interest in the employer in excess of 50%, may agree, with spousal consent, as necessary, to "forego receipt" of all or a portion of his or her benefit until the liabilities of all other plan participants have been satisfied, or
- Assets will be allocated upon plan termination on a strict pro-rata basis.

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Example 3, Rev. Rul. 80-229--foregoing of benefits

Example 3 of Rev. Rul. 80-229 illustrates this:

The plan has two employees: A, a shareholder employee whose benefits are not nonforfeitable, and B, a rank and file employee whose benefits are nonforfeitable. If the assets are required to be allocated in accordance with § 4044(a) of ERISA; only "B" will receive an asset allocation, because his benefits are fully vested.

It is not permissible to reallocate assets to both A and B. The rank and file employees must receive at least the same percentage of the present value of their accrued benefits as the employees who are officers, shareholders, or highly compensated; to avoid discrimination within the meaning of IRC § 401(a)(4).

See PBGC Reg. § 4041.21(b)(2) and Quality Assurance Technical Alerts dated April 2, 2004 and July 28, 2005.

Underfunded plans - Waiver of benefit violates specific requirements

A participant cannot "waive" her accrued benefit. The reduction of a benefit upon plan termination reduces the accrued benefit of the participant and therefore violates IRC § 411(d)(6), 411(a), and 401(a)(13).

Waivers in the form of a plan amendment will violate the Code's prohibition against the reduction of an accrued benefit by plan amendment. *See* IRC § 411(d)(6) and Treas. Regs. §1.411(d)-4, Q&A 2(a)(1).

Waivers may also violate IRC § 411(a), which provides that an employee's right to her normal retirement benefit be nonforfeitable upon the attainment of normal retirement age under the plan.

See Technical Alert dated July 28, 2005.

Underfunded plans - Disregarded service

For purposes of determining an employee's accrued benefit under the plan, the plan may disregard service performed by the employee with respect to which she has received a distribution of the present value of her entire nonforfeitable benefit.

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Underfunded plans, Continued

Underfunded plans – waiver of benefit-assignment and alienation	Assignments or alienations violate provisions of IRC § 401(a)(13)(a) and Treas. Regs. §1.401(a)-(13)(c)(1)(i).
Underfunded plans – never approve a waiver	Specialists should never approve a "waiver" of accrued benefits. Instead, the applicant should be advised that the waiver declaration or election form be rescinded and this should be replaced by a declaration or election form signed by the majority owner, with spousal consent, as necessary, to forego receipt of all or part of her or her benefit until all benefit liabilities of all other plan participants have been satisfied.

Reversion and vesting

Reversion – Caveat – Tips for Determinations Specialists

If the 5310 indicates there will be a reversion to the employer, caveats 6, 9, and 8503 should be included on the 1132 determination letter.

These caveats alert the sponsor of the additional filing requirements and generate the Benefit Assurance Form that is required to be submitted by the plan sponsor after the distribution of assets and reversion to the employer.

Reversion - referrals

If a reversion has occurred, the appropriate referral form(s) should be completed to alert EP Classification Unit that follow-up action is needed:

- Form 5666 – TE/GE Referral Information Report
- Form 5346 – Examination Information Report

The referral should indicate whether the employer has included the reversion as income on the employer's tax return for the year of the reversion and whether the employer has paid the excise tax on the reversion.

Accelerated vesting-who must be fully vested

Accelerated vesting is triggered upon plan termination, partial termination, or a complete discontinuance of contributions to a profit sharing plan.

A plan is not qualified unless it provides for full vesting upon the occurrence of these events.

See IRC section 411(d)(3).

Complete plan termination

Introduction

When a plan terminates, the accrued benefits of all "affected employees" must become 100% vested. The term “affected employees,” however, is not defined by statute.

See IRC section 411(d)(3).

In a defined contribution plan, an "affected employee" has been interpreted to mean an employee or former employee who has not forfeited his nonvested interest as of the termination date.

The IRS expressed this view in GCM 39310 and FSA 1992-1023-1 (a Field Service Memorandum issued in 1992).

Timing of forfeitures

Whether the nonvested interest in a defined contribution plan has been forfeited before the plan’s termination date will depend on the plan’s terms.

If a forfeiture does not occur until the end of the 5-year break in service period described in IRC§411(a)(6)(C), the nonvested portion will become vested if the plan termination occurs prior to the fifth break in service.

If the forfeiture occurs before the fifth break in service, on account of a cash-out distribution as permitted under Treas. Reg.§1.411(a)-7(d)(4), the nonvested portion will become vested only if the plan termination occurs before the forfeiture is incurred pursuant to the cash-out distribution.

Cash-out provisions

In most plans that use the cash-out forfeiture, the forfeiture is triggered immediately upon the distribution of the vested interest. Where the cash-out distribution forfeiture is triggered, a participant is not an “affected employee” if the plan terminates after the date of such forfeiture, even if the plan termination date occurs before the end of the participant’s 5-year break in service period.

Unless a cash-out distribution forfeiture occurs sooner, a participant is an “affected employee” if the plan terminates before the end of the 5-year break in service period, because until that time, the nonvested interest has not been forfeited.

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Complete termination – dissolution of plan sponsor

In *Borda v. Hardy, Lewis,Pollard and Page, P.C*. 138 F.3d 1062 (6th Cir. 1998), the 6th Circuit held that a terminated employee was not an “affected” employee when the plan terminated due to the dissolution of the plan sponsor. The former employee’s vested interest was not cashed-out and he had not incurred his fifth consecutive break in service before the plan terminated. Nonetheless, the court ruled that he did not become 100% vested when the plan terminated.

The court distinguished GCM 39310 because a former employee is “affected” by a plan termination only if the termination itself prohibits the individual from restoring his right to increase vesting in his benefit. In this case, the dissolution of the employer, not the termination of the plan, affected the former employee’s right to vest in his benefits, and consequently, the vesting rule of IRC §411(d)(3) is not applied.

<u>Note:</u> A plan administrator relies on this court ruling at her own risk. This may be a strained interpretation of§411(d)(3) and there is no guarantee that the Service will agree with this interpretation for qualification purposes. In addition, former employees may still challenge such an interpretation of §411(d)(3), particularly those employees who are not within the jurisdiction of the 6th Circuit.

Complete termination – “Affected employees”-DB plan

A defined benefit plan cannot use the 5-year break in service rule to forfeit nonvested benefits unless it is a fully-insured plan.

See IRC §411(a)(6)(C).

Therefore, all employees and former employees with accrued benefits under the plan are "affected employees" for plan termination purposes, without regard to whether they have incurred a 5-year break in service before the plan’s termination date.

DB plan with cash out provisions

For DB plans which contain cash-out forfeiture provisions, any former employee whose vested benefit is cashed-out will forfeit the nonvested benefit at that time. A subsequent plan termination would then not result in any additional vesting for the former employee.

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Complete plan termination, Continued

Unfunded benefits

A defined benefit plan must provide for nonforfeitability of all benefits accrued to the date of plan termination to the extent funded. *See* IRC §411(d)(2) and Treas. Reg. §1.411(d)-2(a). However, an employer is not required to fund accrued benefits that remain unfunded after the plan has terminated.

Employees who are laid off

Courts have held that employees who are laid off do not vest in their benefits when a plan does not have sufficient assets to pay benefits, even though there may be enough assets in the trust to pay just the benefits of the laid-off employees.

See Freeman v. Central States Pension Fund, 32 F.3d 90 (4th Cir. 1994).

In other words, the court analyzed whether there would be sufficient assets to pay all vested benefits (determined without regard to the partial termination) if the plan were to terminate, not just the benefits of the laid-off employees. Since on a termination basis, all assets would be allocated to pay benefits already vested, pursuant to the allocation rules under ERISA §4044, the plan did not have to accelerate the vesting of the nonvested benefits of the laid-off participants due to the partial termination.

Plan subject to Title IV

However, if a plan is subject to Title IV of ERISA (i.e., a PBGC-covered defined benefit plan), the employer may need to fully fund the plan in order to terminate it, unless the employer can satisfy the criteria for distress termination under ERISA §4041(c).

Complete discontinuance of contributions

Introduction

If there is a complete discontinuance of contributions to a profit sharing plan, the plan is treated as terminated for vesting purposes and the affected employees must become 100% vested. *See* IRC section 411(d)(3).

A profit sharing plan or stock bonus plan is not qualified unless it provides for full vesting in the event of a complete discontinuance of contributions. Rev. Rul. 89-53.

A complete discontinuance applies only to profit sharing plans and does not apply to plans subject to IRC §412.

NOTE: If plan participants are fully vested at all times, then complete discontinuance is not an issue.

Avoiding discontinuance

Although employers are not required to make contributions every year to a profit sharing plan:

- Contributions must be recurring and substantial,
- If the amount is not significant enough to reflect an intent to continue the plan, the Service will treat contributions as discontinued, and
- A plan may still receive contributions without regard to current or accumulated profits of the employer. IRC §401(a)(27).

Complete discontinuance - factors

The following are factors used in determining whether a discontinuance has occurred:

- Whether the employer uses the term “suspension” to avoid full vesting,
- Whether contributions are recurring and substantial,
- Whether there is a reasonable probability the discontinuance will continue indefinitely.

See Treas. Reg. §1.411(d)-2(d)(1)(i).

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Complete discontinuance of contributions, Continued

Presumption of discontinuance

Under the Service's audit guidelines, an issue of discontinuance arises when the employer has failed to make substantial contributions for at least 3 years in a 5-year period.

In such a case, a presumption is made that a complete discontinuance has occurred the burden shifts to the employer to present evidence that a complete discontinuance has not occurred.

See Announcement 94-101.

Complete discontinuance - timing

There are two rules to determine the timing of a complete discontinuance:

1. In the case of a single employer plan, the discontinuance becomes effective not later than the last day of the employer's taxable year following the taxable year in which the last substantial contribution was made.

2. If the plan is maintained by more than one employer, the discontinuance becomes effective with reference to the last day of the *plan* year following the *plan* year within which the last substantial contribution was made by the employer.

Complete discontinuance – continuation of elective deferrals under a 401(k) plan, but discontinuance of all other employer contributions

Determining whether a complete discontinuance of contribution has taken place becomes more complicated when an employer discontinues making nonelective contributions to a 401(k) plan, but continues the 401(k) arrangement.

While the Service has not formally ruled on this issue, the IRS has indicated that the elimination of matching contributions and profit sharing contributions under a 401(k) plan does not trigger full vesting because the continuation of elective deferrals under the 401(k) arrangement is a continuation of employer contributions.

Elective deferrals are treated as employer contributions under IRC §402(e)(3), and the 401(k) arrangement is part of the profit sharing plan or stock bonus plan. *See* "response to Q&A-22" in the IRS Q&A Session at the October 2003 ASPPA Annual Conference in Washington, D.C.

Partial termination

Introduction

Whenever employees participating in a plan of the employer are excluded, a partial termination should be considered. Partial terminations can occur in connection with a significant corporate event such as a closing of a plant or a division, or as a result of general employee turnover due to adverse economic conditions or other reasons that are employer initiated. Some examples include:

Example-change in business location

An employer established a qualified pension plan covering all of its 15 employees. The employer later acquired a new business location 100 miles away and closed the original one.

All employees were given the opportunity to transfer to the new location and continue to participate in the plan, but only 3 chose to do so. The other 12 employees were discharged and their participation under the plan ended. The employer hired replacements for them at the new location.

The revenue ruling concludes that there was a partial termination due to the termination of these employees in connection with the change in business location. *See* Rev. Rul. 73-284, 1973-2 C.B. 139.

Example-closing a business division

An employer established a qualified defined benefit pension plan that covered employees in the two divisions of its businesses. The plan covered 165 employees. The employer closed down one division and terminated 95 participants.

The discharge by the employer of 95 out of 165 participants constituted a partial termination. *See*. Rev. Rul. 81-27, 1981-1 C.B. 228.

Partial termination due to a plan amendment-example

A partial termination may occur due to a plan amendment that excludes employees or adversely affects vesting. For example:

A plan amendment excluded union employees from further participating in the employer's plan.

This resulted in the exclusion of 120 out of 170 participants. A partial termination is deemed to have occurred. (Rev. Rul. 72-439, 1972-2 C.B. 223).

Continued on next page

Partial termination, Continued

Ceasing future accruals- example of partial termination

A decrease in future accruals resulting in a potential reversion would only apply to a defined benefit plan. The potential for a partial termination should be considered in this instance. For example:

An employer ceases future accruals in a defined benefit plan at a time when the fair market value of the assets is greater than the present value of the accrued benefits for all the participants.

A potential for reversion exists since any forfeitures would be likely to cause assets to further exceed the present value of accrued benefits.

No partial termination- plan merger or conversion to a profit sharing plan

A money purchase pension plan is merged or converted into a profit sharing plan. Benefit accruals under the money purchase pension plan cease.

No partial termination has occurred because all employees remain covered under the profit sharing plan, the assets and liabilities retain their money purchase pension plan attributes, and the vesting schedule is the same.

Partial termination – ceasing accruals

In a defined contribution plan the cessation or reduction of benefit accruals does not create or increase the potential for reversion. A potential reversion is not relevant in determining whether there is a partial termination of a defined contribution plan as a result of the cessation or reduction of benefit accruals. *See* Rev. Rul. 2002-42, 2002-2 C.B. 76.

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Partial termination – percentage test

There is a rebuttable presumption that a partial termination has occurred due to participant turnover if the turnover rate of participating employees is at least 20 percent. Rev. Rul. 2007-43. Both vested and nonvested employees are included in this calculation.

See Weil v. Terson Co. Retirement Plan Administrative Committee, 933 F.2d 106 (2 Cir. 1991).

However, if the turnover rate is less In *Haliburton v. Commissioner*, 100 TC 216, 237 (16 EBC 1929) (1993), the court noted that a finding of less than 20% reduction could still be a partial termination "if accompanied by egregious abuse on the part of the employer."

Accordingly, when participants have been terminated in connection with a corporate event, or due to general turnover without a specific corporate event, the turnover rate of participating employees must be determined.

Partial Termination – processing steps to determine the turnover rate

Rev. Rul. 2007-43 describes the determination of the turnover rate. The following terms are used:

- Employer-initiated severance from employment,
- Participating employees,
- Applicable period,
- Routine turnover, and
- Transferred employees.

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Partial Termination – Determining the turnover rate

Divide the number of participating employees who had an employer initiated severance from employment during the applicable period by the sum of all of the participating employees at the start of the applicable period and the employees who became participants during the applicable period.

Partial Termination – Employer initiated severance from employment

For purposes of determining the turnover rate, an employer-initiated severance from employment generally includes any severance from employment other than a severance that is on account of:

- death,
- disability, or
- retirement on or after normal retirement age.

Partial termination – Severance as a result of event outside employer's control

An employee's severance from employment is employer-initiated even if caused by an event outside of the employer's control, such as severance due to depressed economic conditions.

In certain situations, the employer may be able to verify that an employee's severance was not employer-initiated, supporting its claim through items such as information from personnel files, employee statements, and other corporate records.

See GCM 39344; *See* also *Anderson v. Emergency Medicine Associates*, 860 F.2D 987 (10th Cir. 1998).

Participating employees taken into account

For purposes of determining the turnover rate, all participating employees are taken into account, including vested as well as nonvested participating employees.

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Partial termination, Continued

Partial termination – applicable period

For purposes of the turnover rate, the applicable period depends on the facts and circumstances. It is generally a plan year. However, in the case of a plan year that is less than 12 months, the applicable period is the plan year plus the immediately preceding plan year.

However, the applicable period could be a longer period if there are a series of related severances from employment.

For example, *in Matz v. Household International Tax Reduction Investment Plan*, 265 F3d 572 (26 EBC 2121) (7 Cir. 2001), the court allowed the plaintiff to bring in to evidence layoffs that occurred over a 3-year period, on the condition that the plaintiff could show that the layoffs were due to related corporate events.

Partial termination – routine turnover rate

Although facts and circumstances determine whether a partial termination has occurred, a routine turnover rate during an applicable period favors a finding that there is no partial termination for that period.

Factors relevant to determining whether the turnover rate is routine include:

- information on the turnover rate in other periods and the extent to which terminated employees were actually replaced,
- whether the new employees performed the same functions,
- whether the new employees had the same job classification or title, and
- whether the new employees received comparable compensation.

Partial Termination – transferred employees

Employees who transfer to a different controlled group are not considered as having a severance from employment for purposes of calculating the turnover rate if those employees continue to be covered by a plan that is a continuation of the plan under which they were previously covered.

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Partial termination – constructive discharge

Generally, voluntary terminations do not count toward the determination of whether a partial termination has occurred because they are not employer-initiated terminations. However, in some cases employees who appear to terminate employment voluntarily have been found to have terminated on an involuntary under a constructive discharge theory.

Courts have noted that whether a constructive discharge has occurred will depend on a number of factors, including the employer's intent, the working conditions and the reasonably foreseeable impact of the employer's conduct on the employees who quit.

See Kreis v. Charles O. Townley, M.D. & Associates, P.C., 833 F.2d 74 (6th Cir.1987).

Partial termination - consequences

If it is determined that a partial termination has occurred, the employer must reconstruct which participants would have experienced an acceleration of vesting due to the partial termination. Participants who improperly incurred forfeitures are owed more benefits. To the extent those forfeitures have been distributed to other participants and cannot be recovered, the employer will be responsible for making the affected participants whole.

Distributions upon plan termination

Distributions upon Termination

In order to terminate a qualified plan, all plan assets must be distributed as soon as administratively feasible after the date of termination. *See* Rev. Rul. 89-87.

Administratively feasibility is determined by all facts and circumstances of a given case but, generally, must be within one year following the date of plan termination.

Distribution Payment Methods

A qualified plan must provide the payment options for a distribution. A DC non-pension plan may provide for a mandatory (i.e. normal form of benefit) distribution method which is the immediate payment form unless another optional form is chosen by the participant. Alternatively, a plan may provide for several payment forms without one specified as mandatory.

DC Non-Pension Plans Without Annuity Options

If a DC non-pension plan terminates and the plan does not offer an annuity option as a distribution method, the plan may distribute a participant's account balance without regard to the participant's consent, even if the account balance exceeds the involuntary cash-out limit in the plan. *See* Treas. Reg. §1.411(a)-11(e).

This rule does not apply if the employer, or a controlled group of the employer, maintains another DC plan. In this case, the participant's account balance may be transferred, without the participant's consent, to the other plan of the employer if the participant does not consent to an immediate distribution.

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Distributions upon plan termination, Continued

Distribution Restriction on a Terminating 401(k) plan

A § 401(k) plan which terminates cannot distribute the elective deferrals portion of the participant's account if the employer maintains or establishes a successor plan within a certain period of time from the termination date. *See* IRC § 401(k)(10)(A).

Elective deferrals include all of the following:

- Pre-tax elective deferrals
- Roth elective deferrals
- Catch-up elective deferrals
- Qualified non-elective contributions (QNECs)
- Qualified matching contributions (QMACs)
- Safe Harbor § 401(k) contributions

All members of a controlled group or an affiliated service group are treated as the same employer. *See* Treas. Reg. § 1.401(k)-1(d)(4)(i).

Distributions – Successor plans

A successor plan is any alternative DC plan that is maintained by the same employer at any time during the period beginning on the date of the plan termination and ending 12 months after distribution of all assets from the terminated plan. Treas. Reg. § 1.401(k)-1(d)(4).

Treas. Reg. § 1.401(k)-1(d)(4) also provides certain other plans will not be considered successor (i.e. alternative) plans for this purpose:

- Employee Stock Ownership Plan (ESOP) as defined in § 4975(e)(7) or § 409(a)
- Simplified Employee Pension Plan (SEP) as defined in § 408(k)

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Distributions – Successor plans (continued)

- Saving Incentive Match Plan for Employees (Simple IRA) as defined in § 408(p) – added by Final § 401(k) Regulations
- § 403(b) plans – added by Final § 401(k) Regulations
- § 457(b) plans – added by Final § 401(k) Regulations
- § 457(f) plans – added by Final § 401(k) Regulations

If less than 2 percent of the eligible employees under the § 401(k) plan are eligible to participate under another plan maintained by the same employer at any time during a 24-month period which begins 12 months before the termination date.

Distributions – elective deferrals

If a successor (alternative) plan exists, the elective deferrals can be:

- Transferred to the successor plan and the distribution restrictions for the elective deferrals must be retained in the successor plan (most commonly used approach)
- Kept in the terminated plan until a distributable event occurs such as severance from employment.

The trustee/plan administrator can purchase a deferred annuity which will delay the distribution.

Distributions – no successor plan

If no successor (alternative) plan exists, the plan must disperse elective deferrals in a lump sum distribution. *See* IRC § 401(k)(10)(B) and § 402(e)(4)(D).

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Distributions – successor plans – processing procedures

Review line 17(m) and any attachment to the application to verify if the employer maintains another plan which could be considered a successor plan.

Additionally, if a new plan is being adopted, as indicated on line 10(e) of the Form 5310, verify it is not a successor plan within the timeframe under Treas. Reg. § 1.401(k)-1(d)(4).

Distributing the assets Miscellaneous rules – top heavy

Top heavy minimums are not required after the plan termination date. Any minimum benefit liabilities that accrued as of the termination date, but have not been funded, are still part of the plan termination liabilities. *See* Treas. Reg. §1.416-1, T-4.

Distributing the assets Miscellaneous rules - Notice

Notice to Participants:

- 30-180 days before date of distribution, participants must receive notice of their election rights with respect to the distributions to be made from the terminated plan,
- Notices should be delivered only when it is reasonable to expect distribution can be made within next 180 days, and
- Participant may waive minimum 30-day notice period (but distribution may not commence less than 8 days after notice is given, if QJSA rules apply).

Distributing the assets Miscellaneous rules – QJSA & consent

The Sponsor must provide an explanation of a QJSA benefit option and the distribution must be in a QJSA form unless the spouse consents to a different form of payment, such as a lump sum or direct rollover.

Spousal consent is not required if the present value of vested accrued benefit is $5,000 or less.

If the present value of vested accrued benefit exceeds $5,000, the distribution cannot be made without participant's consent, unless the participant has reached normal retirement (or age 62, if later).

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Distributions upon plan termination, Continued

Distributing the assets Miscellaneous rules – Direct rollover option

Direct rollover notice must be provided if the form of payment to the participant is eligible for a rollover.

The following rules apply:

- A minimum 30-day notice period (may be waived by participant) must be provided¸

- Mandatory distributions in excess of $1,000, which are made on or after March 28, 2005, are generally required to be rolled over to IRAs in the absence of an affirmative participant election.

Important Issues to Watch-Prohibited transactions

Prohibited transactions

The purpose of the prohibited transactions rule is to protect the interests of plan participants by prohibiting dealings between the plan and person who may have conflicts of interest with the plan.

Prohibited transactions – statutory authority

A prohibited transaction (PT) is defined as any direct or indirect:

- Sale, exchange, or leasing of any property between a plan and a disqualified person,
- Transfer of real property to a plan where the property is subject to a mortgage placed upon the property by a disqualified person within 10 years prior to the transfer,
- Property transferred subject to a mortgage which the plan assumes,
- Lending of money or other extension of credit between a plan and a disqualified person,
- Furnishing of goods, services, or facilities between a plan and a disqualified person,
- Transfer to or use by or for the benefit of a disqualified person of the income or assets of the plan,
- Act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or his own account,
- Receipt by a fiduciary of any consideration from a party dealing with the plan in connection with a transaction involving income or assets of the plan, or
- Acquisition and holding of employer securities or employer real property in excess of the ERISA §407 limits.

See IRC §4975(c)(1)(A) through (G).

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Prohibited transactions – disqualified person

A disqualified person (DP) is any individual or entity who has one or more relationships with the plan as described in IRC §4975(e)(2). The disqualified person may not engage in a transaction involving the assets of the plan.

Some examples include:

- Fiduciary,
- Owner,
- Employers,
- Unions and their officials, and
- Family members of the fiduciary.

15% tax

IRC §4975(a) imposes a 15% non-deductible excise tax on the amount involved with respect to a PT which occurs in a tax year to be paid by the disqualified person.

If the PT is not corrected, IRC §4975(b) imposes a 100% non-deductible excise tax.

A qualified plan which engages in a prohibited transaction does not become a disqualified plan solely by reason of the transaction. However, under certain circumstances, the activities which constitute prohibited transactions might result in a violation of the exclusive benefit rule under IRC §401(a)(2), which is a disqualifying event.

Prohibited transactions – participant-directed accounts

The prohibited transaction rules are applicable even if investments are participant-directed. *See* DOL Reg. §2550.404c-1(e)(3).

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Prohibited transactions – exemptions for sales, exchanges, or leases

IRC §4975(d)(20), as added by section 611(d) of the PPA 2006, provides for an exemption from the prohibited transactions for a sale, exchange or lease described in IRC §4975(c)(1)(A) if:

(1) the transaction is between a plan and a disqualified person who is not a fiduciary (or affiliate) who has or exercises authority or control over the investment of the plan assets involved in the transaction nor provides investment advice with respect to such assets,

(2) the person is a disqualified person solely by reason of providing service to the plan or solely by reason of a relationship to such service provider described in IRC§4975(e)(2)(F), (G), (H), or (I) , and

(3) the plan receives no less than, or pays no more than, adequate consideration for the transaction. In the case of an asset other than a security for which there is a generally recognized market, adequate consideration means the fair market value of the asset as determined in good faith by a fiduciary or fiduciaries in accordance with regulations prescribed by the DOL. *See* ERISA §408(b)(17)(B) and IRC §4975(f)(10).

Issues to watch-Unrelated Business Taxable Income (UBTI)

Unrelated Business Taxable Income (UBTI

The purpose of the unrelated business taxable income (UBTI) provisions of the IRC is to ensure that exempt organizations are taxed on income earned from activities that are unrelated to the purpose for which they were granted exempt status.

IRC §511 imposes a tax on any unrelated business taxable income of all organizations exempt under §401(a) and 501(c) with the exception of organizations described in §501(c)(1).

IRC §512(a)(1) defines UBTI as the gross income derived from any unrelated trade or business regularly carried on, less the deductions that are directly connected with the carrying on of the trade or business.

IRC §513(a) defines an unrelated trade or business as activity which is not substantially related to the exercise of the purpose for the exemption of the trust.

UBTI - Trade or business

A trade or business, generally, includes any activity carried on for the production of income from the sale of goods or from the performance of services.

Determining whether or not an activity is a trade or business, depends on the facts and circumstances of each case.

The types of trades or businesses carried on by exempt employee trusts vary widely. Frequently, the trust will engage in the same business activity as the employer, using, either directly or indirectly, the same management as the employer. Some trusts also engage in an activity that complements the business of the employer. The trust may perform all or a part of the marketing or manufacturing functions. Some trusts may invest in real estate, instead of renting or leasing the property. The trusts often show the income as other income. Additionally, rental of personal property such as automobiles, office machines, computers, vending machines, etc. will usually give rise to UBTI. The existence of any personal property in the trust assets is an indication that possible UBTI may exist.

In some instances, determining the possible existence of a trade or business can be resolved by looking at the financial statements of the trust.

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Issues to watch-Unrelated Business Taxable Income (UBTI), Continued

UBTI – regularly carried on

In determining whether a trade or business is regularly carried on, the frequency and continuity with which the trade or business is conducted and the manner in which it is pursued are relevant factors. Treas. Regs. §1.513-1(c)(i)

The purpose of UBTI is to place exempt trust business activities on the same basis as the nonexempt businesses with which they compete.

Specific business activities of an exempt trust will ordinarily be deemed as regularly carried on if:

- There is a frequency and continuity, and
- It is pursued in a manner generally similar or comparable to commercial activities of nonexempt organizations.

The "normal time span of activities" is the criterion used to determine if the business is regularly carried. *See* Treas. Reg. §1.513-1(c)(2).

The Regulations provide that when income producing activities of a nonexempt commercial organization are ordinarily conducted on a year round basis, the carrying on of these same activities by an exempt organization for only a few weeks would generally not be the regular carrying on of a trade or business.

UBTI – income exempt from UBTI

There are several exceptions and limitations on UBTI. The following income from the trade or business is not deemed UBTI:

- Dividends, Interest, and Annuities,
- Royalties,
- Gains and Losses From the Sale of Property, and
- Rents - Real Property.

See IRC §512(b).

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Issues to watch-Unrelated Business Taxable Income (UBTI), Continued

UBTI- Royalties

Royalties are excluded in computing UBTI. Income from a working interest in a mineral property, however, is not excluded from UBTI calculations, if the following conditions exist:

- The working interest is used in a regularly carried on trade or business, and
- The exempt trust is not relieved of its share of the development costs by the operator.

Income from the working interest is not excluded since the relationship between the parties is, in substance, that of a partnership or joint venture. Under such a relationship, the amount received by the plan is not a royalty.

UBTI – gains and Losses from Sale of Property

Also excluded from taxation are all gains and losses from the sale, exchange, or other disposition of property other than:

- Stock in the trade,
- Property that would be includible in inventory at the close of the Taxable year, and
- Property held primarily for sale to customers.

*This exclusion does not apply to the cutting of timber.

UBTI – rents – Real property

Income from the rental of only real property as part of a regularly carried on trade or business is always excluded from UBTI.

Treas. Regs. §1.512(b)-1(c) defines real property for purposes of determining UBTI as all real property including any property described in IRC §1245(a)(3)(C) and § 1250(c) and the regulations hereunder.

Issues to watch--plan assets

Plan Asset Verification and valuation

The primary purpose of the plan must be to benefit the employees and their beneficiaries. Treas. Regs. §1.401-1 outlines the conditions under which a plan is considered to be for the exclusive benefit of employees and their beneficiaries. The employer may not use the plan as a subterfuge for distribution of benefits or (prior to the satisfaction of all plan liabilities on termination of the plan) divert any corpus or income to purposes other than the exclusive benefit of employees or their beneficiaries.

The plan sponsor is required to report the statement of net assets available to pay benefits as of the proposed date of termination (or the last valuation date) on line 20 of Form 5310.

Plan assets – Line 20(a) Non-interest bearing cash

Form 5310, line 20(a), Non-Interest Bearing Cash – any money or items that do not receive interest. Examples could include: art, collectibles, coins, IRC 408(m), etc.
.
If the balance sheet indicates an amount under this line item, then:

- Refer to line 17(e) on Form 5310
- Secure a description of the asset
- Secure purchase documentation
- Secure a copy of the appraisal within the last 3 years.
- Verify the plan allows for in-kind distributions
- Verify if all participants have been given the option of having a distribution in kind
- Secure an explanation of the allocation to participants

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Issues to watch--plan assets, Continued

Plan assets – line 20(b)(1) Employer Contribution Receivables

Line 20(b)(1) of Form 5310 provides for a receivable of trust assets consisting of employer contributions not yet deposited into the trust. If the balance sheet indicates an amount under this line item, first, verify the item was not previously paid under line 11 of Form 5310, then:

- Secure an explanation of the nature of the receivables, and
- Secure documentation to verify the amount was paid

IRC § 412(c)(10) and Temporary Treas. Regs. §11.412(c)-12 require the contribution to the plan to be made no later than 8½ months after the close of the plan year.

Plan assets – Line 20(b)(2) Participant Contribution Receivables

Line 20(b)(2) of Form 5310 provides for a receivable of trust assets consisting of participant contribution not yet deposited into the trust. If the balance sheet indicates an amount under this line item, then:

- Secure an explanation of the nature of the receivables, and
- Secure documentation to verify the amount was paid

In order for a contribution to be considered timely, the deposit must be made no later than the 15th day of the month following the month in which the contribution was withheld by the employer from the employee's wages or the amount is received by the employer. However, the regulations do state that contributions must be segregated from the employer's general assets at the earliest date it can reasonably be accomplished. *See* §2510.3-102(b).

Plan Assets – Line 20(b)(3) Income Receivables

Line 20(b)(3) of Form 5310 provides for a receivable of trust assets consisting of income generated when there is an investment in CDs, bonds, etc.

If the balance sheet indicates an amount under this line item, then:

- Secure an explanation of the nature of the receivables, and
- Secure documentation to verify the amount was paid.

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Issues to watch--plan assets, Continued

Plan assets – Line 20(b)(4) other receivables

Line 20(b)(4) of Form 5310 provides for a receivable of trust assets from other investments. Generally, this is “catch-all” category for any receivable not listed on the application. This could include money due to the trust due to an overpaid distribution to a participant or a correction made by the employer or plan administrator.

If the balance sheet indicates an amount under this line item, then:

- Secure an explanation of the nature of the receivables, and
- Secure documentation to verify the amount was paid.

Plan assets – General investments

Trust assets are invested by the trustee in accordance to the terms of the plan and the fiduciary standards under ERISA.

Some common types of investments include and require no further information:

- Interest bearing cash – a checking account earning interest
- Certificates of deposits (CDs) – similar to a savings account but is a promissory note issued by the bank which restricts holders from withdrawing the funds until a specific time period (e.g., 5 years) and can include either a fixed or variable interest rate
- U.S. Government securities – securities issued by either local or national governments
- Corporate debt instruments – bonds or notes issued by a corporation
- Corporate stocks – stocks issued by a corporation which provide for voting rights and possible dividends
- Registered investment companies – mutual funds or investment company which are registered with the Securities and Exchange Commission (SEC) which comply with any legal requirements

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Issues to watch--plan assets, Continued

Plan assets – Other investments

The following are other general investments which require additional information to ensure they do not constitute UBTI:

- Non-interest bearing cash
- Partnership/joint venture
- Real estate - income producing or non-income producing
- Loans secured by mortgages (other than loans to participants)
- Participant loans
- Other loans
- Insurance investments
- Other investments
- Employer related investments
- Buildings and other property used in plan operation

Plan assets – Partnership/Joint Ventures

Line 20(c)(6) on Form 5310 will provide the amount invested in any partnerships/joint ventures. A partnership/joint venture is a partnering between two or more entities to share the risk of investment and expertise.

Any income derived by the partnership/joint venture is disclosed on a Form 1065, *Schedule K-1*. The partnership identified on the form is typically a real estate investment partnership with the trust being a limited partner that merely receives a flow-through of investment earnings.

If the balance sheet indicates an amount under this line item, then:

- Secure an explanation of the type of business, and

- Secure the most recent K-1's.

Review this information to ensure no income constitutes UBTI or involves a Prohibited Transaction.

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Issues to watch--plan assets, Continued

Plan assets – Line 20(c)(7), (8) – Real estate income or non-income producing

Lines 20(c)(7)(A) and (B) of Form 5310 provides for general investments in real estate, either income or non-income producing. If the balance sheet indicates an amount under this line item, then:

- Secure an explanation of the purpose of the real estate,
- Secure purchase documentation,
- Secure a copy of the appraisal within the last 3 years,
- Verify the plan allows for in-kind distributions,
- Verify if all participants have been given the option of having a distribution in kind, and
- Inquire if it is debt financed.

Plan assets – line 20(c)(9), (10) – Loans – Participant or Other

Lines 20(c)(9) and (10) of Form 5310 provides for general investments in participant or other loans.

A loan to a participant in the plan is limited to the greater of (I) one-half of the present value of the nonforfeitable accrued benefit of the employee under the plan, or (II) $10,000. *See* IRC §72(p)(2)(A)(ii).

A loan must be repaid within 5 years, unless the loan is used to acquire the principal residence of the participant. *See* IRC § 72(p)(2)(B)(i).

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Plan assets – line 20(c)(9), (10) – Loans – Participant or Other (continued)

If the balance sheet indicates an amount under these line items, then:

- Verify the terms of the plan allow for participant loans
- Verify if the terms of the plan allow for more than one outstanding loan at one time
- Secure a copy of the loan document for each participant loan and review the amount, date, and repayment schedule of each loan
- Identify and verify if any participant is a disqualified person and has met the requirements for the exception under the PT rules
- Verify the dollar amount of the each loan did not exceed 50 percent of the participant's vested account balance (there is an exception to this rule for Hurricane Relief)
- Verify the time period to repay the loan does not exceed 5 years and if it does, verify it meets the home loan exception
- Reconcile the loan document to the amortization and/or repayment schedule for each loan to verify the loans were timely paid
- If any of the loans are in default and if the plan administrator has established a cure period, verify the missed loan payments were made within the correct timeframe
- If there are any outstanding loans at the termination date of the plan, verify either the participant will repay the outstanding balance prior to any distribution, or the outstanding balance will be offset by the amount of the participant's distribution.

If the loan violated §72(p), prepare the Form 5666 – *TEGE Referral Information Report* to report the taxable income to the participant.

Plan assets – other loans

Line 20(c)(10) on Form 5310 provides for any other loan amount. If the balance sheet indicates an amount under this line item, then:

- Secure an explanation of the purpose of the loan,
- Secure the loan documentation, and
- Verify the terms of the loan(s) and the loan(s) maturity date

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Plan assets – Insurance investments

Line 20(c)(12) on Form 5310 provides for any amount invested in insurance.

Special attention should be given if the plan assets include life insurance contracts, specifically “springing cash value” types of insurance. Typically, a “springing cash value” life insurance contract is purchased by a plan for an employee when the plan terminates. The stated cash surrender value of the policy for a specified number of years (e.g., the first 5 years) is very low compared to the plan assets used to purchase the contract.

At a time when the cash surrender value is low, the policy is distributed to the employee following the end of the specified period. The cash surrender value “springs up,” becoming greater than the total plan assets used to purchase the contract. If the balance sheet indicates an amount under this line item, then:

- Verify that the plan values the contracts using the total policy reserve value instead of the stated cash surrender value,
- Verify that any resulting increase is included in the distributee’s taxable income upon distribution, and
- Prepare the Form 5666 to report the increase in the participant’s taxable income.

Refer to IRM 7.12.1.18.1 for additional guidance on springing cash value contracts.

Line 20(c)(13) on Form 5310 provides a “catch all” for any other investments not provided on another line item. If the balance sheet indicates an amount under this line item, then:

- Secure an explanation or description of the investment.

- Once it is determined what this investment is, you may need to secure additional information such as purchase documentation, valuation reports, appraisals, etc.

Continued on next page

Plan assets-Employer related investments – Line 20(d), (2)

Line 20(d)(1) and (2) of Form 5310 provides for employer-related investments in securities and real property.

Specialists should pay particular attention to investments in obligations or property of the employer or any related entity. The existence of such contributions or investments indicates the possibility of improper deductions, prohibited transactions, debt financed income, or valuation problems which could violate the exclusive benefit rule or result in discriminatory allocations.

If the balance sheet indicates an amount under these line items, then:

- Secure a description of the property or securities,
- Determine how the property or securities were acquired,
- Secure documentation of the purchase,
- Secure the most recent appraisal or valuation, and
- Inquire if the property or securities are debt financed.

Plan assets – Buildings and other property

Line 20(e) on Form 5310 provides for any investments in buildings and other property used in plan operation.

If the balance sheet indicates an amount under this line item, then:

- Secure an explanation or description of the investment.
- Once the investment is determined, additional information may be needed such as purchase documentation, valuation reports, appraisals, etc.

Plan assets – liabilities – benefit claims payable

Line 20(g) of Form 5310 provides for any distributions which are payable to retirees, beneficiaries, or participants who had a severance from employment but has not been sent as of yet.

If the balance sheet indicates an amount under this line item:

- Secure the name of the person being paid,
- Explain the nature of the payable, and
- Estimate the date and amount of the payment.

Continued on next page

Issues to watch--plan assets, Continued

Plan assets – liabilities – operating payables

Line 20(h) of Form 5310 provides for any amount that is payable for the operation of the plan. If the balance sheet indicates an amount under this line item, then:

- Secure a detailed explanation of the nature of the payable,
- Secure documentation of the date and amount of the payment, and
- Verify the operating payables are allowable.

Plan assets – liabilities – Acquisition indebtedness

Line 20(i) of Form 5310 provides for any acquisition indebtedness. Acquisition indebtedness is the debt incurred to acquire an asset, such as real estate, stock, bonds, etc. If the balance sheet indicates an amount under this line item, then:

- Secure a detailed explanation of the transaction
- - Once it is determined what the debt is, additional information may be needed such as purchase documentation, valuation reports, appraisals, etc.

Plan assets – liabilities – other liabilities

Line 20(j) of Form 5310 is a "catch-all" line item for any other liabilities not listed on the application. If the balance sheet indicates an amount under this line item, then:

- Secure a detailed explanation for the liability.
- Once it is determined what the other liability is, additional information may need to be secured such as purchase documentation, valuation reports, appraisals, etc.

Plan assets – Zero assets

If line 20 of the Form 5310 indicates the assets are valued at zero:

- Secure documentation to verify the date of distribution of all assets.
- Secure documentation to determine the investment of the assets prior to the distribution.
- Secure documentation to explain the allocation of assets to participants.
- • If the assets were distributed more than one year prior to the date of the Form 5310, secure documentation to verify the application met the requirements of section 8 or Rev. Proc. 2007-44.

Issues to watch--Minimum funding standards

Minimum Funding Standards

The Employee Retirement Income Security Act of 1974 (ERISA) added IRC § 412 and 4971. These sections established strict minimum funding standards for pension plans and imposed an excise tax on the plan sponsor for failing to satisfy these requirements.

IRC § 412 provides for a funding requirement for pension plans which consists of defined benefit plans, money purchase plans, and target benefit plans.

The minimum funding requirement ensures there will be enough assets in the trust to pay the definitely determinable benefit under Treas. Regs. §1.401-1(b)(1)(i).

Minimum Funding Standards – determining the contribution amount

The annual required contribution for a defined contribution plan is based on the contribution formula in the plan document.

For a defined benefit plan, the annual required contribution is determined by an actuary and is based upon interest rates (the rate at which assets are expected to grow), mortality factors (how long a participant is expected to life), salary increases, and/or turnover rates with the company.

Timing of contributions and excise taxes

IRC §412 and (c)(10) requires the contribution to be deposited no later than 8½ months after the close of the plan year.

If the required minimum funding is not contributed timely, a 10% (5% for multiemployer plans) excise tax under IRC § 4971(a) is imposed on the employer at the end of the plan year for any taxable year in which there is a funding deficiency.

This is sometimes referred to as the “first tier tax” and cannot be waived by the Service.

100% tax

If this deficiency is not corrected, a 100% penalty tax is then imposed under IRC §4971(b), sometimes referred to as the “second tier tax”.

Continued on next page

Issues to watch--Minimum funding standards, Continued

Abatement of tax

This tax is abated if correction is made within 90 days after the Service issues a notice that the tax is due. *See* Rev. Proc. 2000-17, Rev. Rul. 89-87, and Rev. Rul. 79-237.

Funding deficiency is carried over to next year

If the funding deficiency is uncorrected for more than one year, the minimum funding deficiency for the second year will include both the:

1. the deficiency for the first year, plus

2. the additional deficiency created in the second year, etc.

Thus, a funding deficiency will carry forward to the subsequent plan year and beyond until it is corrected which the resulting sum is referred to as an "accumulated funding deficiency".

Excise tax for money purchase plans

NOTE: Specialists are cautioned not to pursue the §4971 excise tax for affected money purchase pension plans after the effective date of PPA until technical guidance has been issued. *See* FY 2011-1 Interim Guidelines (EP Examinations)- IRC §4971 & Money Purchase Pension Plans after PPA.

Liability of contributions and effect of waiver

An accumulated deficiency is not eliminated just because the plan is terminating. Additionally, an accumulated deficiency cannot be deemed corrected by having plan participants "waive" their accrued benefits.

Liability for controlled groups

If the employer is a member of a controlled group, each member of such group will be jointly and severally liable for the payment of the contribution. *See* IRC §412(b)(2).

Multiemployer plans in which the related group members are not liable for the funding or the excise tax will not be held liable. *See* IRC §412(c) and §4971(e).

The minimum funding rules do not apply to governmental plans and non-electing church plans. *See* IRC §412(h).

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Processing steps for Determinations Specialists:

Review the Form 5310, the plan document(s) and amendment(s), and any supplemental information closely to determine if a funding deficiency occurred.

1. Verify an amendment to the plan has been timely adopted to freeze the plan for any further benefits or contributions.

2. Verify an amendment to the plan has not reduced or eliminated a protected benefit under IRC § 411(d)(6).

3. Verify if the participant(s) have met the requirements to accrue the protected benefit for the plan year.

4. Verify the date and amount of the last employer contribution(s) shown on line 11 on Form 5310, the proposed date of termination shown on line 7(a) on Form 5310, and/or the plan provisions for determining the accrued benefit or allocation to the plan.

5. If there are any employer receivables on line 20 of Form 5310, reconcile this amount with the amount shown on line 11 of Form 5310 and/or secure documentation to verify the timely payment of the receivable.

6. If a plan is subject to IRC § 412 and terminates on a date later than the stated date of termination, additional funding may be required.

7. If an accumulated funding deficiency exists, verify the employer completed Line 17(f) on Form 5310 indicating the amount of the deficiency, whether a funding waiver was granted by the Service, and a copy of the filed Form 5330 or waiver ruling was included in the submission package.

8. If a funding deficiency exists, Form 5621 should be documented with the complete details on how the correction was made stating the method(s), amount(s), and date(s) of payment and when a Form 5330 was filed.

Continued on next page

Issues to watch--Minimum funding standards, Continued

Procedures for exam referral

If it is determined that a funding deficiency exists, Form 5666, Referral for Examination, should be completed and the procedures under Quality Assurance Bulletin 2004-3 should be followed.

Plan Amendments required for terminating plans

Introduction

Rev. Proc. 2013-6 (updated annually) states that a terminating plan must be amended for all current law that is applicable to the plan as of the date of termination.

Rev. Proc. 2013-6 section 12.05 provides that a plan that terminates after the effective date of a change in law, but prior to the date that amendments are otherwise required, must be amended, in connection with the termination, to comply with the applicable provisions of the law from the date on which such provisions became effective with respect to the plan. *See* IRM 7.12.1.4.

Remedial amendment period is accelerated

Rev. Proc. 2007-44 section 8 states that the remedial amendment period for any law changes in effect as of the termination of the plan is accelerated when the plan terminates.

An application will be deemed to be filed in connection with plan termination if it is filed no later than the later of

(1) one year from the effective date of the termination, or

(2) one year from the date on which the action terminating the plan is adopted.

However, in no event can the application be filed later than twelve months from the date of distribution of substantially all plan assets in connection with the termination of the plan.

Remedial Amendment Cycles

Rev. Proc. 2007-44 (which superseded Rev. Proc. 2005-66) established cyclical RAPs under IRC § 401(b) for individually designed and preapproved plans.

Generally, most IRC § 401(a) individually designed plans have a 5-year RAC. The cycles are staggered and spread over 5-year periods generally based on the last digit of the Employer’s Identification Number (EIN).

Within each 5-year cycle, employers have a specific time to file for a determination letter. That filing period is the last 12 months of the cycle and runs from February 1 to January 31.

Continued on next page

Plan Amendments required for terminating plans, Continued

Cumulative List

The Cumulative List of Changes in Plan Qualification Requirements is published annually, generally around mid-November. The CL is intended to identify all changes in the qualification requirements resulting from statutory, regulatory, or other changes in guidance published in the Internal Revenue Bulletin (IRB) that are required to be taken into account in the written plan document for an upcoming cycle.

First 5 year RAC

- A 1 or 6 2005 Notice 2005-101
- B 2 or 7 2006 Notice 2007-03
- C 3 or 8 2007 Notice 2007-94
- D 4 or 9 2008 Notice 2008-108
- E 5 or 0 2009 Notice 2009-98

Second 5 year RAC

- A 1 or 6 2010 Notice 2010-90
- B 2 or 7 2011 Notice 2011-97
- C 3 or 8 2012 Notice 2012-76
- D 4 or 9 2013
- E 5 or 0 2014.

Plan amendments for terminating plans

NOTE: Any remedial plan amendments or other required plan amendments for a terminating plan must be adopted in connection with the plan termination regardless of whether such requirements are included on the most recently published Cumulative List.

2011 Cumulative List-plan qualification requirements not on prior cumulative lists-Notice 2011-97

Rev. Rul. 2011-1-group trusts

Rev. Rul. 2011-1, 2011-2 I.R.B. 251, revises the generally applicable rules for group trusts and, if certain requirements are met, permits the participation in group trusts of custodial accounts under § 403(b)(7), retirement income accounts under § 403(b)(9), and governmental retiree benefit plans under § 401(a)(24). This revenue ruling also modifies the transition relief provided in Rev. Rul. 2008-40.

Section 401(a)(22)

IRC 401(a)(22): Notice 2011-19, 2011-11 I.R.B. 550, provides that the terms readily tradable on an established securities market and readily tradable on an established market mean employer securities that are readily tradable on an established securities market within the meaning of § 1.401(a)(35)-1(f)(5) for purposes of § 401(a)(22).

Notice 2011-19 is effective for plan years that begin on or after January 1, 2012, except for certain plans that have a delayed effective date.

Section 401(a)(28)(C)

IRC 401(a)(28)(C): Notice 2011-19, 2011-11 I.R.B. 550, provides that the terms readily tradable on an established securities market and readily tradable on an established market mean employer securities that are readily tradable on an established securities market within the meaning of § 1.401(a)(35)-1(f)(5) for purposes of § 401(a)(28)(C).

Notice 2011-19 is effective for plan years that begin on or after January 1, 2012, except for certain plans that have a delayed effective date.

Section 409

IRC 409: Notice 2011-19, 2011-11 I.R.B. 550, provides that the terms readily tradable on an established securities market and readily tradable on an established market mean employer securities that are readily tradable on an established securities market within the meaning of § 1.401(a)(35)-1(f)(5) for purposes of § 409(h)(1)(B) and § 409(l).

Notice 2011-19 is effective for plan years that begin on or after January 1, 2012, except for certain plans that have a delayed effective date.

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2011 Cumulative List-plan qualification requirements not on prior cumulative lists-Notice 2011-97, Continued

Section 411(a)(13)	**411(a)(13):** Notice 2011-85, 2011-44 I.R.B. 605, extends the deadline for adopting an interim or discretionary amendment under § 411(a)(13) (other than § 411(a)(13)(A)).
Section 411(b)(5)	**411(b)(5):** Notice 2011-85, 2011-44 I.R.B. 605, announces that the Treasury Department and the Service intend to amend the 2010 final hybrid plan regulations to postpone the effective/applicability date of § 1.411(b)(5)-1(d)(1)(iii), (d)(1)(vi), and (d)(6)(i) to plan years that begin on or after a date to be specified in those regulations that is not earlier than January 1, 2013. This notice also extends the deadline for adopting an interim or discretionary amendment under § 411(b)(5).
Section 431(b)(8)	**431(b)(8):** PRA 2010 § 211(a)(2) added § 431(b)(8) to the Code, which provides two special funding rules available to multiemployer plans. Notice 2010-83, 2010-51 I.R.B. 862, provides guidance with respect to the special funding rules under § 431(b)(8).

2012 Cumulative List-qualification requirements

Section 401(a)

IRC 401(a): Notice 2012-6, 2012-3 I.R.B. 293, extends and expands the transition relief provided under Rev. Rul. 2011-1 for certain group trusts, certain retirement trusts that qualify under the Puerto Rico Internal Revenue Code that participate in group trusts, and certain qualified retirement plans that benefit Puerto Rico residents. The notice also provides additional time for governmental retiree benefit plans described in § 401(a)(24) to be amended to satisfy the applicable requirements of Rev. Rul. 2011-1.

Section 401(a)-normal retirement age

IRC 401(a): Notice 2012-29, 2012-18 I.R.B. 872, provides that the Service and Treasury intend to modify the normal retirement age regulations to clarify that governmental plans that do not provide for in-service distributions before age 62 do not need to have a definition of normal retirement age and to modify the age-50 safe harbor rule for qualified public safety employees.

The notice also provides that the Service and Treasury intend to amend the normal retirement age regulations to extend the effective date for governmental plans to annuity starting dates that occur in plan years beginning on or after the later of:

(1) January 1, 2015 or

(2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is 3 months after the final regulations are published in the Federal Register.

Section 411(a)-direct rollovers

IRC 411(a): Rev. Rul. 2012-4, 2012-8 I.R.B. 386, describes whether a qualified defined benefit pension plan that accepts a direct rollover of an eligible rollover distribution from a qualified defined contribution plan maintained by the same employer satisfies §§ 411 and 415 in a case in which the defined benefit plan provides an annuity resulting from the direct rollover.

Section 411(a)(13)

IRC 411(a)(13): Notice 2012-61, 2012-42 I.R.B. 479, provides that certain provisions in the 2010 final hybrid plan regulations will not be effective for plan years beginning before January 1, 2014.

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2012 Cumulative List-qualification requirements, Continued

Section 411(d)(6)-bankruptcy	**IRC 411(d)(6):** Final Regulations under § 411(d)(6), which provide an additional limited exception to the anti-cutback rules to a plan sponsor who is a debtor in a bankruptcy proceeding, were published on October 8, 2012 (77 Fed Reg. 66915).
Section 415	**IRC 415:** Rev. Rul. 2012-4, 2012-8 I.R.B. 386, describes whether a qualified defined benefit pension plan that accepts a direct rollover of an eligible rollover distribution from a qualified defined contribution plan maintained by the same employer satisfies §§ 411 and 415 in a case in which the defined benefit plan provides an annuity resulting from the direct rollover.
Section 417	**IRC 417:** Rev. Rul. 2012-3, 2012-6 I.R.B. 383, describes how the qualified joint and survivor annuity ("QJSA)") and the qualified preretirement survivor annuity ("QPSA") rules, described in §§ 401(a)(11) and 417, apply when a deferred annuity contract is purchased under a profit sharing plan.
Section 420	**IRC 420:** Sections 40241 and 40242 of MAP-21 amend § 420 to extend the provisions relating to transfers of excess pension assets to retiree health accounts and to expand those provisions to allow transfers to retiree group term life insurance accounts.
Section 436	**IRC 436:** §1.436-1 provides guidance on the application of § 436, which provides a series of limitations on the accrual and payment of benefits under underfunded single employer defined benefit plans.
Section 436-relaxtion of rules	**IRC 436:** Notice 2011-3, 2011-2 I.R.B. 263, provides guidance on the special rules relating to the relaxation of § 436 rules that were included in the funding relief for single employer defined benefit pension plans under PRA 2010. (New)

Continued on next page

2012 Cumulative List-qualification requirements, Continued

Section 436-sample plan amendment	**IRC 436:** Notice 2011-96, 2011-52 I.R.B. 915, provides a sample plan amendment that plan sponsors may adopt to satisfy § 436 regarding limitations on the accrual and payment of benefits. The notice also extends both the deadline to amend a plan to satisfy § 436 and the period during which such an amendment is eligible for relief from the anti-cutback requirements of § 411(d)(6). (New)
Section 436-extension for plan amendment	**IRC 436:** Notice 2012-70, 2012-51 I.R.B. This notice extends the deadline, as set forth in Notice 2011-96, 2011-52 I.R.B. 915, to amend a defined benefit plan to satisfy the requirements of § 436 and provides associated relief from the requirements of § 411(d)(6).

Verifying prior law, issue focus report and other items

Verifying prior law, IRM 7.12.1.3

Specialists should always verify that the plan was properly amended for prior legislation. The scope of review should include verification of compliance with the applicable Cumulative List (CL) for the remedial amendment cycle (RAC) immediately preceding the current cycle in which the application was submitted.

Example

A taxpayer with an Employer Identification Number (EIN) ending in 4 submits a Form 5310 application on March 15, 2013 for an individually designed plan.

Since the EIN ends in 4, the taxpayer would normally fall under cycle D. Therefore, the scope of the review must begin with the preceding cycle D RAC. The applicable CL for cycle D is the 2009 Cumulative List.

Example- proving prior law compliance

In order to prove prior law compliance, the taxpayer may provide either:

- A copy of the FDL for the plan's prior RAC.

- A timely adopted plan document/adoption agreement for the plan's applicable CL for the prior RAC.

If employer cannot prove timely amendments

If the taxpayer cannot prove that the plan was timely amended for the provisions of the applicable Cumulative List for the prior RAC, the specialist should request managerial approval to expand the scope of review to include laws prior to the plan’s initial cumulative list.

Additionally, if it is determined that a plan has not been timely amended for prior law, the plan is considered to have a qualification failure as described under Rev. Proc. 2013-12 and a closing agreement may be needed to correct the failure.

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Verifying prior law, issue focus report and other items,
Continued

Issue Focus Report

Specialists should use the Issue Focus Reports on Terminations for help determining whether new laws are relevant to a particular terminating plan. To find these reports, go to the TEGE intranet site http://tege.web.irs.gov/home.asp and follow these steps:

- Select "My Job" on the top of the page.
- Select "Case Closing" under the Revenue Agent section.
- Scroll to the "Determinations and Determinations Quality Assurance" section and go to the Determinations and Determination Quality Assurance section.

Interim Amendment Requirements

For a disqualifying provision or a provision that is integral to a disqualifying provision, an interim amendment must be adopted by the later of the due date (including extensions) for filing the income tax return for the employer's taxable year that includes the date on which the remedial amendment period begins or the last day of the plan year that includes the date on which the remedial amendment period begins.

Section 5.06 of Rev. Proc. 2007-44 provides special amendment deadlines for tax-exempt employers and government entities.

Tips for agents - Which law changes are applicable for your review?

Example: A defined benefit plan terminates on March 1, 2013. Review for compliance with the 2012 cumulative list and any other guidance effective as of 3/1/13 even if the due date is after 3/1/13. The plan should comply with PPA and the Final NRA Regulations, HEART, WRERA, PRA 2010, MAP-21, and any optional changes from the 2012 cumulative list.

For determination agents

Complete the applicable Cycle C worksheets found on the H drive.

If the plan does not have a prior determination letter, check for compliance with those law changes as well (2007 cumulative list assuming no cycle changing events) but do not caveat requirements not listed on the 2012 cumulative list (2007 CL items and earlier) on the 1132 letter.

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Verifying prior law, issue focus report and other items,
Continued

For exam agents

- If the plan has a favorable determination letter that does not rule on the plan termination, review the plan for compliance with law changes after the CL the determination letter rules on through the date of termination.
- If the plan has a favorable determination letter upon termination, form qualification has already been reviewed by a determination agent and no additional information is necessary.
- If the plan does not have a favorable determination letter, review the plan for all applicable laws, regulatory guidance or other published guidance subsequent to GUST, including timely "good faith" EGTRRA, interim and discretionary amendments effective through the year of examination, as specified under the applicable CL

No guidance issued after October 1, 2012

The 2012 cumulative list will not include guidance issued after October 1, 2012 – verify any guidance issued after this date which is required to be effective as of the termination date.

Filings With Governmental Agencies

IRS – Form 5310

The application for a determination letter upon termination of a plan is filed on a Form 5310, Application for Determination for Terminating Plan.

IRS – Submission information

Rev. Proc. 2013-6 and the instructions to Form 5310 require certain items to be submitted with a Form 5310 application. These include:

- The appropriate user fee and Form 8717,
- A complete copy of the plan document(s) and all amendments made since the last favorable determination letter,
- A copy of the last favorable determination letter, if applicable,
- A copy of the latest opinion or advisory letter, if applicable,
- A copy of all records of all actions taken to terminate the plan, And
- Copies of all required attachments and statements.

Notice 2012-61

Notice 2012-61 requires the following items be submitted (or subsequently obtained if not in original application package) for defined benefit plan terminations:

- A signed and dated actuary's certification of the AFTAP for the last 2 years which includes the year of termination, and
- A Schedule SB to the Form 5500 for the last 2 years which includes the year of termination and for any other year in which the AFTAP was below 80 percent (the 80 percent is replaced with 100 percent in any year in which the plan sponsor is a debtor in bankruptcy).

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Filings With Governmental Agencies, Continued

AFTAP certification

The AFTAP certification must be in writing, certified and signed by the enrolled actuary. The AFTAP should also be shown on the Schedule SB to the Form 5500, and this must also be provided to the plan administrator. Certain items and information must be included on the AFTAP certification, including:

- Plan year in which the AFTAP applies to,
- Value of the plan assets,
- Prefunding balances (credit balance),
- Funding standard carryover balance (credit balance),
- Value of the funding target,
- Aggregate amount of annuity purchases taken into account in AFTAP,
- Unpredictable contingent event benefits permitted to be paid, and
- Plan amendments that took effect in current plan year.

IRS - Timeliness of application

Rev. Proc. 2007-44, Section 8, states that an application will be deemed to be filed in connection with the termination if it is filed no later than the later of:

1. one year from the effective date of the termination, or
2. one year from the date on which the action terminating the plan is adopted.

However, in no event can the application be filed later than twelve months from the date of distribution of substantially all plan assets in connection with the termination of the plan.

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Filings With Governmental Agencies, Continued

IRS- Why file?

Why file an application for a determination letter when it is not required? There are a number of reasons sponsor will file a request for a DL. For example:

- Trustees may require to transfer assets,
- Provides an extension to distribute if requested prior to PBGC notification,
- Provides some certainty that plan is qualified upon termination,
- May help identify any issues prior to distribution,
- IRAs may require proof that rollover was from qualified plan, or
- Critical for plans with excess assets (overfunded).

DOL – Form 5500

The employer must continue to file the Form 5500, Annual Report of Employee Benefit Plans, until such time all the assets of the trust have been distributed.

PBGC - filing

This relates only to defined benefit plans that are covered by Title IV of ERISA.

- Standard termination: Form 500- only if plan assets are sufficient to pay all liabilities
- Distress termination – Form 601 – only if plan is underfunded. NOTE: sponsor and all controlled group members must be in “distress” (i.e. bankruptcy, reorganization).